The Opaque Champions

A Relational Anatomy of China's Large State-Owned Enterprises

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ABSTRACT

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China's once dilapidated state-owned enterprises (SOEs) have grown into powerful giants. After three decades of reform, China's SOEs now comprise over 60 percent of the largest 500 companies in China and more than 15 percent of Fortune Global 500 companies in the world. Pervasive state ownership continues with no sign of vanishing as a salient feature of Chinese corporate governance. Despite their economic importance, the SOEs' organizational structure and governance remain obscure to outsiders. The obscurity is attributable partly to the secretive culture of the Chinese government but also more importantly to the way scholars have approached this topic. Scholars of Chinese corporate governance have focused on listed firms, but China's listed SOEs are embedded in business groups which have extended ties with various corporate and non-corporate entities. To fully understand the governance and behavior of China's SOEs, it entails an approach that looks beyond the listed firms and considers the complex organizational relations surrounding the SOEs.

This dissertation shows that China's large industrial SOEs are organized as vertically integrated corporate groups under the government ownership agency (SASAC) with strategic linkages to other business groups as well as to various governmental organs. The vertical ownership structure helps power centralization and masks many actual governance practices from the public eye. There are many hidden institutionalized connections to various state/party organs that play a more influential role than visible shareholding ties. The SOEs also have

constructed intergroup strategic ties that facilitate cross-group collaboration to achieve their globalization ambition. Furthermore, the making of the managerial elite presents a high degree of cohesion and closure, which strengthens the relations across SOEs themselves and with other government organs. The party-state uses such various connections to embed SOEs in a control network that facilitates resource collaboration across multiple spheres of the state system and maintains the economic foundation of the Party's ruling.

The anatomy of the relations surrounding China's large SOEs provides contextualized explanations for the malfunction of many governance institutions such as the board of directors, independent directors and executive compensation The density of the state's control network also suggests the limitation of reforming SOE governance through partial privatization and internationalization.

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INTRODUCTION

Why a Relational Approach?

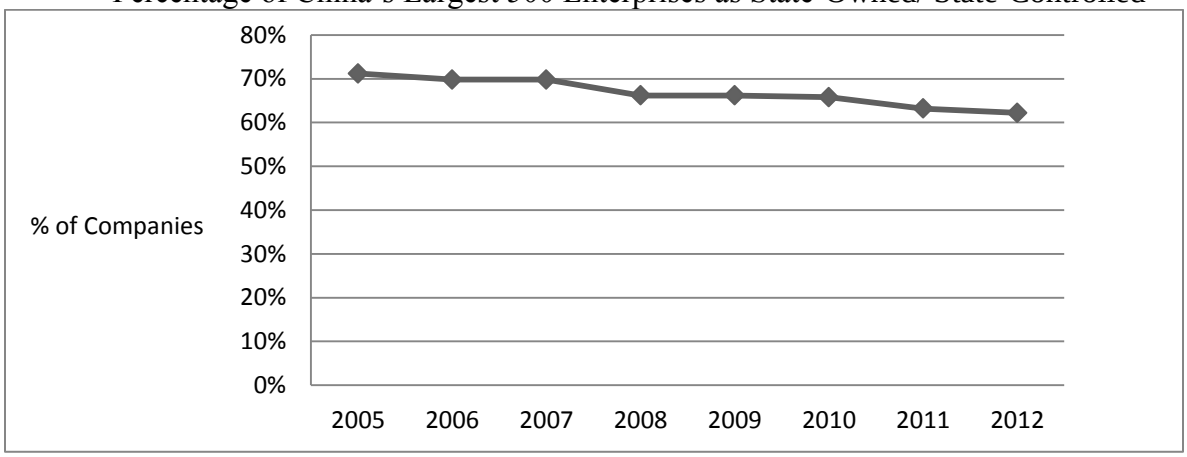
The downfall of Eastern European and Soviet Socialism and the softening of Chinese Communism in the 1980s appeared to conclusively declare a victory of the free market capitalism. The victory however turns out to be rather uncertain as the twenty-first century unfolds. The financial crisis in 2008 unabashedly disgraced liberal capitalism. The US economy, the champion of free market, has even resorted to government ownership for relief. Meanwhile, "the crisis of Western liberal capitalism has coincided with the rise of a powerful new form of capitalism in emerging markets" (Economist 2012) – frequently described as state capitalism.

State capitalism is now often characterized as "a system in which governments use state-owned companies and investment vehicles to dominate market activity" (Bremmer & Stewart 2010). This form of state capitalism is a long-term policy decision rather than a transient measure to rebuild a devastated economy or to lift an economy out of recession. Moreover, state capitalists use markets as a device to serve national interests, or at least those of ruling elites, as well as to magnify their political and economic power domestically and internationally (Bremmer 2010:51-52).

China is regarded as the world's leading practitioner of state capitalism. Back in the late twentieth century, China's SOEs were hopeless in every aspect and seemed destined to either bankruptcy or mass privatization. After three decades of reform, these once dilapidated SOEs have grown to powerful giants. While fewer in number, SOEs still comprise over 60 percent of the largest 500 companies in China (Figure 1). The average revenues of the SOEs are 1.55 times as those of the Chinese private enterprises, the average assets as 4.4 times and the average profits as 3.15 times (Figure 2). China's SOEs now also comprise about 15 percent of the Fortune

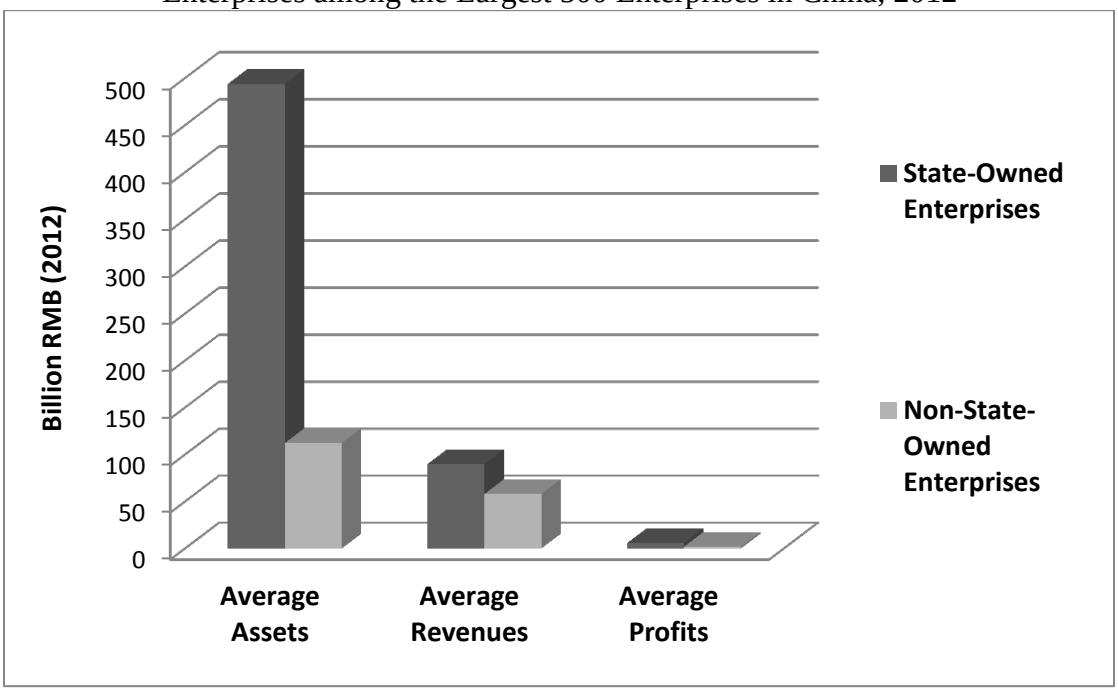
Global 500 companies in the world (Figure 3). Pervasive state ownership continues with no sign of vanishing as a salient feature of Chinese national economy and corporate governance.

[Figure 1]
Percentage of China's Largest 500 Enterprises as State-Owned/ State-Controlled



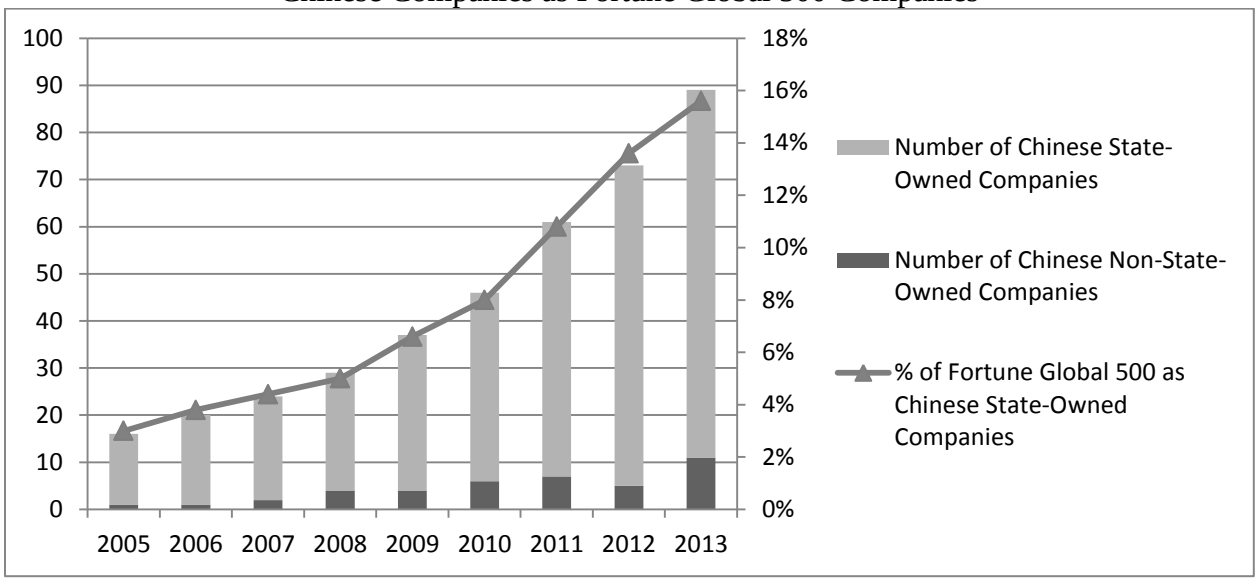
Data Source: raw data released by China Enterprise Confederation and China Enterprise Directors Association; compiled by author.

[Figure 2]
Comparison of the Average Financial Performance between State-Owned and Non-State-Owned Enterprises among the Largest 500 Enterprises in China, 2012



Data source: raw data released by China Enterprise Confederation and China Enterprise Directors Association; compiled by author.

[Figure 3]
Chinese Companies as Fortune Global 500 Companies



Data Source: raw data from Fortune Global 500, compiled by author.

The prominence of China's SOEs has drawn considerable scholarly attention to their governance features, but to date how these mega-sized SOEs are governed remains opaque. The secretive culture of China's state-controlled institutions presents a great obstacle to revealing the inner workings of their governance. Furthermore, and more importantly, the way that scholars have approached this subject fails to penetrate into the murkiness of the governance system. The typical approach to understanding the governance of China's SOEs is focused on the publicly-listed company from the perspective of agency theory in economics. As a result, it examines the institutions that monitor management such as the board of directors, independent directors, securities regulations or other mechanisms commonly used in Western companies. This typical approach often leads to a conclusion that these internationally-recognized governance institutions are lacking or dysfunctional in China's SOEs (e.g. Cheung et al. 2008). This common conclusion raises an obvious puzzle: how can a system void of the formal institutions that are deemed important to Western companies produce a large army of Fortune Global 500 companies? What are the mechanisms that actually govern these mega-sized companies?

The typical approach to Chinese corporate governance overlooks an important fact that China's large SOEs are organized as business groups within which a great number of member companies are connected with one another through various types of relations. The publicly traded companies are only one of several types of entities embedded in the business network. While a few scholars (economics-trained) have noticed business groups as an important organizational feature of Chinese state-owned companies, they tend to simply take the group feature as a dummy variable (i.e. affiliated with a group or not) for evaluating the effect on financial performance of publicly-traded companies (Singh and Gaur 2009, Guest and Sutherland 2009, Carney et al. 2009). These studies however shed little light on how the relations within and beyond the business groups are organized. Without an understanding of the internal and external relations of the business groups, it is hard to fully explain the effects of group affiliation, whether positive or negative.

Sociologist Lisa Keister offered some insights into the internal structure of some Chinese business groups in the late 1980s to 1990s. Keister (1998, 2001, 2009) examined various types of interfirm relations within Chinese business groups including interlocking directorship ties, lending relations, sales relations, and personnel exchanges. Keister (1998) found that the presence and predominance of interlocking directorships in a Chinese business group improved member companies' profitability and productivity due to faster flows of market and technological information. Moreover, there was a positive correlation among the presence of lending, sales and personnel relations in a business group (Keister 2001). Keister (2000) also showed that Chinese business groups having connections with foreign firms tended to perform better. While insightful, Keister's subjects of study were experimental business groups before the major state ownership supervision reform introduced in the early twenty-first century. Moreover,

Keister's studies considered only firm relations within the boundary of a business group rather than external relations to other types of government units. Since SOEs are known as inextricably embedded in the state system, this inward looking into business groups should integrate with an investigation of external institutional connections in order to provide a comprehensive account of the operation of China's SOEs. Furthermore, Keister's studies analyzed intra-group relations from the perspective of industrial production rather than of corporate governance that concerns the distribution of powers and rights among various stakeholders in the system. The organizational relations among member companies in fact may serve not only production purposes but also political control goals intended by the Chinese state-owner. Thus, it entails an analysis of the internal and external connections of China's business groups and how such network structure advances economic and political goals.

Relations are an important object of study in economic sociology. Mark Granovettor, a founding theorist in the field of economic sociology, argues that "[economic actions] are embedded in concrete, ongoing systems of social relations" (1985: p.487) and criticizes the atomization of economic agents in classical and neo-classical economics. Social relations can facilitate information flows, trust formation as well as constrain opportunistic behavior. Over the past decades, Mark Granovettor's theoretical insights combined with the advent of social network analysis (a quantitative methodology to investigate network properties) have catalyzed sociologists' interests in the roles of interpersonal and interorganizational relations in economic activities. At the interpersonal level, Granovettor (1974), for example, finds that professionals primarily rely on their personal contacts rather than formal or impersonal channels to get information about job-change opportunities. A wealth of studies on the importance of *guanxi* in the Chinese economy essentially represents a branch of research on interpersonal relations in

economic sociology (Gold, Guthrie, and Wank, eds. 2002). The prevalent use of social or personal ties in China's economic development raises a still underexplored question: where do such social connections come from? Li et al. (2010) find that organizational relations significantly affect the formation of governmental ties in Chinese manager's social network. In other words, organizational relations create opportunities for actors to construct social or personal connections. To further the relational approach to Chinese economic development, it is important to investigate the organizational relations through which Chinese SOEs are connected among themselves and with other types of entities including government and non-government units.

At the interorganizational level, economic sociologists are interested in investigating how a set of organizations are connected with one another by a particular type of relationship and how such organizational networks affect behavior and performance. A vast majority of business network studies are focused on one-mode networks composed of either interlocking directorship ties (e.g., Mizruchi 1996; Davis 1991, 1996, Davis & Greve 1997; Davis et al. 2003; Vedres & Stark 2010), ownership/equity connections (e.g., Kogut & Walker 2001; Stark & Vedres 2006), or contractual relations such as strategic alliances (e.g., Gulati & Gargiulo 1999) among a population of similar companies. A small number of sociological network studies investigate relations across different types of organizations such as interlocking directorships between business and non-business organizations, i.e., two-mode networks in social network analysis parlance. Moore et al. (2002) for example, found that there were substantial leadership linkages among the government, nonprofit and for-profit organizations in the United States. Grant (2012) found a substantial increase in the interlocking directorships between for-profit and non-profit organizations in the United States as non-profit organizations have become more dependent on

external sources provided by business organizations. Overall, existing organizational studies suggest that firms can have "multiple-embeddedness" – firms can be connected through multiple types of relations among themselves and with multiple types of organizations.

Rich empirical evidence suggests organizational relations can provide information advantages, reduce transaction costs, relieve external environment uncertainties, and improve reputation or legitimacy (for empirical reviews, Oliver 1990, Podolny & Page 1998). These functional purposes may be utilized by the pro-development government to attain not only successful firm performance but also national economic growth, such as in the case of the Japanese and Korean business groups (Granovettor 2005; Gilson & Milhaupt 2011; Jones & Sakong 1980). The successful experience of the Japanese and Korean groups derived from the benefits of organizational networks prompted the Chinese government to assemble the SOEs into business groups (Keister 1998). China's state-owned business groups are not only internally connected among member companies but also externally connected with other state-controlled organs. Understanding the organizational relations within and outside the state-owned business groups helps to reveal the actual governance structure of China's SOEs. It cements the gaps that are unobservable or unanswerable by the typical method which is focused on the individual (listed) firm.

Inspired by network studies in economic sociology, this dissertation adopts a relational approach to understanding the governance of China's SOEs. The relational approach is to focus on how the Chinese SOEs are connected with one another and with other types of entities through various types of organizational and to a less extent personal relations. In other words, this relational approach investigates the "multiple embeddedness" of China's SOEs. Turning the attention onto organizational relations beyond personal connections (*guanxi*) helps to reveal not

only institutional sources of where social ties come from but also the macro-institutional structure supporting corporate and national economic growth. This dissertation depicts various types of organizational relations including equity, strategic, supervisory, personnel connections as well as relations with the banking and the international business world. It further employs legal, regulatory, sociological, historical, and comparative methods to explain the formation, functions and implications of the organizational connections.

Through the relational approach, this dissertation shows that China's SOEs are deeply embedded in the party-state system, not only through ownership connections but also (more importantly) various control channels beyond the rights of a typical controlling shareholder. The hierarchical ownership structure of the business groups helps the concentration of power in the hand of the Chinese party-state. The state-owned business groups' connections with various state-controlled organs facilitate resource flows and policy implementation across the business and political spheres within the state system. The deep embeddedness in the party-state system however raises the concerns about "over-embeddedness" especially in terms of corporate governance improvement. The internal network of a business group helps Chinese SOEs hide actual governance practices; the extensive integration into the party-state system increases the risk of running the SOEs more like government units rather than modern corporations; and the high elite closure may perpetuate the old management practices due to lacking access to new management skills and outside talents. In this regard, the challenge of reforming the SOEs, at least for the Chinese ruling elite, is how to strike a balance between closure and openness, and between control and autonomy.

One way to structure openness is to make connections to the non-state actors especially foreign companies. As many Chinese SOEs are expanding internationally and building

connections with foreign companies, it raises a question about how the governance of the SOEs would change under their globalization plan. Do international connections serve as an impetus of SOE governance reform? A relational approach to this question suggests investment creates not only flows of money but also channels of influence. The Chinese SOEs through foreign equity connections may be exposed to influence from where they invest and whom they partner with. The chances of governance improvement would be promising if they are mainly connected to countries of "good governance." It entails an empirical investigation of the geographic distribution of the SOEs' foreign exposure.

This dissertation makes two scholarly contributions. First, existing network studies are typically focused on individual corporate behavior while this dissertation extends network approaches to understanding the inner workings of a national economy. Second, this dissertation is an attempt to explore the interdisciplinary study of corporate law and sociology. Scholars of corporate law primarily (in fact almost exclusively) rely on economic theories to analyze corporate governance issues but have little exposure to sociological approaches. The corporate law community's ignorance of sociological approaches is a quite unfortunate phenomenon given that business school scholars, another major group specialized in corporate governance, are trained in sociology and/or borrow lots of ideas from sociology. This dissertation demonstrates an example of the limitation of economics and the usefulness of sociology in understanding corporate governance in one of the world's major economies. The relational approach helps to explain by which specific institutional mechanisms actual corporate governance practices diverge from the laws on the books.

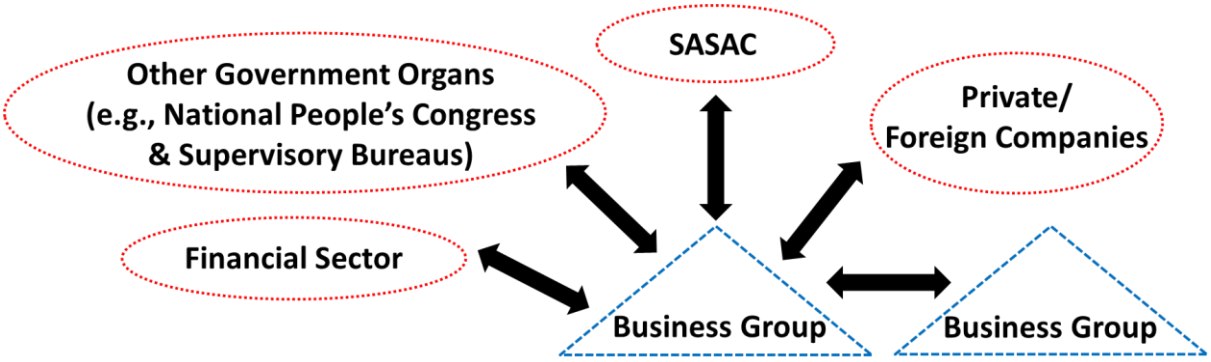
A Relational Framework of the Chinese State-Owned Enterprise

A relational anatomy of China's state-owned enterprises (SOEs) is to reveal how the Chinese SOEs are connected with one another and with other types of entities through various types of relations and draw implications of these connections. Using the terminology of social network analysis, the relational anatomy comprises two rudimentary concepts: actors and relational ties (Wasserman & Facust 2009). The actors consist of state-owned enterprises, government units and private business entities while the relational ties include ownership, strategic, personnel, supervisory and symbolic connections.

SOEs as the focal actor include state-owned or state-controlled business organizations. In China, financial and non-financial SOEs are structured and regulated in different ways. In this dissertation, the industrial non-financial SOEs are the focal actors and financial SOEs (e.g., banks) are brought into analysis through their connections with non-financial SOEs. Most of the large industrial SOEs in China now have been incorporated as closely held companies and some as publicly-listed companies with the state as the controlling shareholder. Existing literature on Chinese SOEs primarily focuses on the publicly-listed state-controlled companies such as China Mobile Limited, a large Chinese telecommunication company listed on the New York and Hong Kong stock exchanges, China Petroleum & Chemical Company (commonly referred as Sinopec Corp.), a large oil company listed on the New York, Hong Kong and Shanghai stock exchanges. These publicly-listed companies are not atomized entities but in fact embedded in business groups which are controlled by wholly state-owned closed companies. For example, China Mobile Limited is a member company of the China Mobile Group controlled by China Mobile Communication Corporation; Sinopec Corp. is a member of the Sinopec Group controlled by China Petrochemical Corporation. These wholly-state-owned closed companies constitute the

largest companies in China; and the business groups that these companies exert control form the focal corporate networks in the landscape of China's SOE sector.

[Figure 4]
A Relational Framework of China's SOEs



The relational anatomy of China's SOEs starts from how a typical state-owned business group is constructed. A typical state-owned business group is composed of a large number of functionally-differentiated SOEs vertically connected with one another through ownership relations. Such a business group is not an isolated network but with extensive connections with various types of entities, including other state-controlled business groups, state-controlled financial institutions, private/foreign companies, and a variety of government organs such as State-Owned Assets Supervision and Administration Commission (SASAC), national party and legislative bodies, and industry-based supervisory bureaus. [Figure 4] shows the basic relational framework adopted in this dissertation. The Chinese SOEs' relations to various types of actors inside and outside the state system constitute the organizational environments in which the SOEs operate.

Based on the relational framework, Chapter 1 presents the stylized model of China's industrial SOEs. The business group structure is the typical organizational form and constitutes the focal network of analysis. This chapter investigates the origin, major components and

organizational structure of the state-owned business groups. It further shows a group's typicality to the stylized model (i.e. how classic to the standard model) correlates with group size but does not promise better performance. This chapter also shows that the state-owned group itself is not an isolated network but with collaborative linkages with other groups. The intergroup connections, often among groups in complementary industries, are designed to facilitate resources sharing for capital-intensive or international expansion projects.

Chapter 2 examines the state-owned groups' various specific connections with the state system. This chapter especially focuses the various governance mechanisms through the ownership tie to the state's ownership agency – State-Owned Assets Supervision and Administration Commission (SASAC). Unpacking the SOEs' formal ownership relation with SASAC reveals how information flows between the government and the SOEs, how the top managers of the SOEs are evaluated, appointed and compensated, and how the assets and profits are transferred in and out of the state system. The anatomy of the SOE's relation with SASAC shows involvement of multiple hidden but influential government strings attached to the SOEs. The state's control network which is composed of multiple connections with SASAC and other government organs is largely invisible in the Chinese company law or securities regulations to which most scholars of Chinese corporate governance pay attention.

Chapter 3 examines the corporate elite of China's SOEs. It investigates the evolution of educational, political and career attributes of the CEOs of China's large SOEs in the past decade. In particular, it traces executive personnel connections within the business groups and across different types of organizations. This chapter utilizes legal, historical, sociological and comparative methods to explain the change and stability of the executive composition of China's large SOEs. The executive recruitment shows an orientation toward politically-bounded and

firm-specific-knowledge professionalism as well as some faint potential of bottom-up and competition-driven marketization. The empirical findings raise questions about the adequacy and capacity of existing international laws and enforcement in coping with the rise of Chinese SOEs, the challenges to improving Chinese corporate governance, and the different underlying forces in forming apparent similarities in elite composition across countries.

Chapter 4 examines how the Chinese industrial SOEs are connected with the banking system. Unlike many major capitalisms where financial institutions (especially banks) occupy the central position of the corporate network, China's state-owned sector present sparse ownership and personnel connections across the industrial and financial worlds. The industrial SOEs do not use direct ownership or personnel connections with the major banks to secure financial resources. The strong capital flows between the industrial firms and the banks are channeled through indirect connections to the ultimate common owner. When resource availability is secured through the ultimate common connection, the major concern for the state as the owner and policymaker shifts toward risk control in the system, which explains the absence of direct lateral ties between the industrial and financial SOEs.

Chapter 5 examines the SOEs' equity connections with foreign companies. China's SOEs have been active in global expansion by foreign direct investment. This chapter uses insights derived from network studies and institutional theory to evaluate the potential influence of the international connections on the SOE governance reform. The empirical evidence in this chapter suggests internationalization is largely irrelevant to the SOE reform pace. International normative or regulatory pressure is unlikely to be an effective force to change the governance of SOEs that are deeply embedded in the party-state's control network.

CHAPTER 1

BUSINESS GROUP AS THE FOCAL NETWORK

1.1 The Emergence of Chinese Business Groups

Chinese business groups historically originated from the indigenous regional integration policy and the influence of the Japanese keiretsu. Since 1979, the Chinese government launched numerous initiatives to integrate the fragmented economic systems that used to be divided along the government bureaucratic jurisdictions. Business groups as an organizational instrument were part of the integration scheme to promote cross-jurisdiction collaboration for industrial production. In 1979, a collection of Chinese scholars visited Japan several times to understand the organization and operation of the Japanese keiretsu and reported their research results to the State Council (i.e. the Cabinet of China) (Hu & Zang 2005). The initial contact with the Japanese keiretsu however did not effectuate an outright adoption of business groups into the SOE reform package. It was not until 1987 that the Chinese government officially adopted business groups as an organizational form for SOE reform. Since then, the definition and organization of Chinese business groups evolved several times and finally became legally-definable in the late 1990s.

Before the early 1980s, the Chinese economic system was fragmented along the bureaucratic jurisdictions. Each jurisdiction (e.g., province or city) was a self-contained system. The industrial structure in each jurisdiction was very similar, comprising a full spectrum of industries. It was under-specialized without considering any comparative advantage of each jurisdiction. Similarly, each enterprise was also a self-contained organization with a full range of production functions and services. There was little cross-industry or cross-jurisdiction production

collaboration among SOEs. The self-sufficiency character meant that a lot of resources were wasted on duplicative investments. The whole production system was inefficient.

From the early 1980s, the Chinese government had launched a series of region-level and enterprise-level initiatives to integrate the disjointed economic systems and improve resource allocation.[1] In 1980, the government introduced the so-called "business alliances" (*jingji lianying* or *jingji lianheti*) as an enterprise-level integration mechanism. The business alliances were to encourage cross-jurisdiction and cross-industry collaboration among SOEs and other institutes (e.g., research centers and universities). The collaboration within a business alliance could take various forms such as stabilizing supply-demand relationships or sharing marketing channels and production facilities. From a legal perspective, a business alliance was not an independent legal entity but a contract-based inter-firm arrangement. Each alliance partner remained as a separate entity. SOEs should enter into a formal agreement in order to form a business alliance.[2] Contracting parties should specify in the agreement the collaboration terms including monetary and non-monetary contribution and profit/loss sharing rules. Moreover, a business alliance should establish an alliance committee composed of representatives of participating parties to manage affairs of the alliance. The business alliance essentially was similar to a multi-lateral strategic alliance commonly found in the modern business world.

Business alliances as an organizational form to reform SOEs were mainly promoted between 1980 and 1986. By the end of 1986, there were approximately 32,000 business alliances,

[1] This dissertation focuses on the enterprise-level rather than region-level integration. Briefly speaking, the regional-level integration was to utilize comparative advantages of different regions and seek more even economic development across regions. In 1981, some Chinese provincial governments established the first collaboration region, the Northern China Economic and Technological Collaboration Region, followed by many similar regional collaboration efforts. Local governments took the advantage of the collaboration region to carry out projects that were beyond a single government's capacity, such as building a large power plant or water system. The regional integration is discussed in a rich literature on regional economy, independent of the literature on business groups.

[2] The Provisional Rules on Promoting Business Alliances laid out the primitive legal design of the business alliances, effective as of July 1, 1980, repealed as of March 23, 1986.

comprising 63,200 SOEs (Wu 2003). But the business alliances fell out of favor in the late 1980s as the Chinese government sought a more integrated form of inter-firm collaboration. The business alliances nevertheless became the building blocks for the construction of business groups in China.

After years of experimentation, business alliances were ineffective in further integrating SOEs due to lack of unified leadership and jurisdictional conflicts. The Chinese government thus shifted from contract-based collaboration to equity-based collaboration by adopting business groups. The SOEs were organized into business groups with the intention to facilitate cross-jurisdiction and cross-industry collaboration, to deepen specialization, to seek economies of scale, to transform scientific research into manufacturing power, to gain competitiveness in domestic and international markets, and to separate the management of the SOEs from the governance logic of the government.[3]

A challenging task to intentionally construct business groups through governmental initiatives was the absence of any readily-available legal framework to refer to. In most countries including Japan, business groups are usually an outgrowth of family business expansion and/or private entities' response to market imperfection without specific regulatory planning. The lack of a definitive legal framework to imitate means that the Chinese government had to produce its own blueprint to construct business groups. The legal history reflects the search for a clear definition of Chinese business groups. The concept of business groups was introduced as early as the late 1980s, but it was not until the late 1990s that the contour and internal organization of Chinese business groups became more legally definable.

[3] *Several Opinions on Constructing and Developing Business Groups*, National Committee of Economic Restructuring and National Committee of Economic Development, released on December 16, 1987.

A business group was initially defined in 1987 as an economic organization comprised of a lead member which could be an enterprise or research institute that produced branded or nationally important products (e.g., iron and coal) and a number of other enterprises or research institutes that had economic or technological connections with one another and with the lead member.[4] The 1987 legal definition did not strictly require ownership connections and in reality most of the groups lacked any shareholding links among group members.[5] Some local governments even transformed administrative bureaus into lead companies and reorganized their supervised SOEs under the newly-created lead companies. A large number of Chinese business groups were created by the government's administrative command rather than SOEs' self-motivation. Unsurprisingly, such business groups did not realize the intended purposes.

To curb the blind craze for business groups, the Chinese central government took more control over the creation of business groups in the 1990s. The State Council constructed 57 experimental business groups in 1991 and then added another 63 experimental groups in 1997. These 120 experimental business groups were mainly in the automobile, machinery, electronics, steel, energy, chemistry, transportation, and textile industries. The Chinese government gave the business groups favorable treatment in trading, taxation, capital resources, and eligibility for listing shares on stock exchanges and so on. In the experimentation scheme, a business group was constructed with a multi-level structure. The first level was a core enterprise, which could be a large manufacturing enterprise or a purely holding company as the core member of the group. The second level included a number of enterprises in which the core member had a controlling stake. The third level included a number of enterprises in which the core member would

[4]Several Opinions on Constructing and Developing Business Groups, Item 2, National Committee of Economic Restructuring and National Committee of Economic Development, released on December 16, 1987.
[5] It was estimated about 70-80% of the groups did not have shareholding links among group members, Fuge Li eds., Zhongguo Qiye Jituan de Xingqi [The Emergence of China's Business Groups] 8 (1990.

gradually develop an equity stake. The fourth level was composed of enterprises that had close trading relations with enterprises in the first three levels. The first and second levels were required and the third and fourth levels were optional but highly recommended to be included.

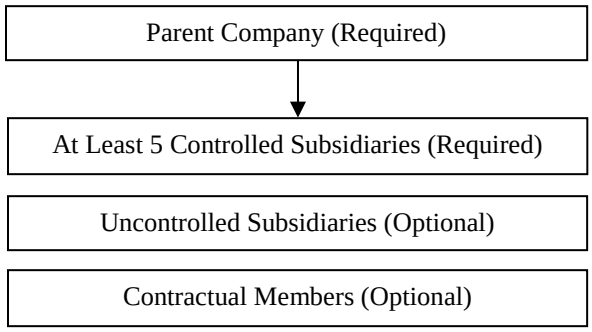
Based on the experiment, a relatively clear legal concept of business groups finally emerged in 1998.[6] A business group is now defined as a group of incorporated entities comprised of a parent company and its controlled subsidiaries as the main members, as well as the parent's uncontrolled subsidiaries and any other incorporated entities that have production collaboration with the core company or its subsidiaries and take the articles of grouping as the rules to govern their common behavior.[7] The articles of grouping are a formal agreement among group members regarding the group's boundaries and governance rules. The legal definition makes ownership connections as the major ties that bind companies into a group. As of 2000, 87% of Chinese business groups included no purely contractually related members (Hahn & Lee 2006).

Under the current regulatory scheme, not all companies are qualified to start a business group. The parent company is required to have registered capital of at least 50 million RMB (about 7.6 million USD) and at least 5 subsidiaries. The total registered capital of the parent and its subsidiaries has to be at least 100 million RMB (about 15 million USD). Moreover, although a business group itself is not a separate legal entity, registration is required if the group wants to be legally recognized and enjoy relevant benefits such as establishing a finance company within the group. Many Chinese companies form *de facto* business groups rather than *de jure* business groups, particularly given that Chinese family businesses have a tradition in organizing family firms into groups. The specific regulations on Chinese business groups are applicable only to *de jure* business groups. [Figure 5] below illustrates the basic structure of a business group

[6] Provisional Rules on Business Groups Registration (1998), promulgated by the State Council.
[7] Article 3 of the Provisional Rules.

according to the Chinese regulatory framework. Because the regulatory scheme is primarily designed to reform SOEs, a large number of the registered business groups are state controlled. As of 2008, 43.5% of the largest 2,971 registered business groups were controlled by the Chinese state.[8]

[Figure 5]
The Basic Legal Structure of a Business Group in China



1.2 Major Actors in the Focal Network

Inside the Chinese state-owned business group, there are several types of actors performing different functions. The major actors include a core company, a finance company, one or more publicly traded companies and research institutes. This section examines in some detail the key actors of the business group.

1.2.1 Core Company

China's large state-owned non-financial enterprises are typically organized as vertically-integrated corporate groups. Each corporate group has a wholly stated-owned holding company standing at the top of the ownership hierarchy, known as the core company of the group. Below the core company are there a large number of subsidiaries including listed companies, finance companies, research institutes, and many other related firms along the production chain.

[8] Statistics Bureau of China, Zhongguo Da Qiye Jituan Jingzhengli Niandu Baogao 2009 [Annual Report on the Competitiveness of China's Large Business Groups 2008]

Historically many of the core companies were created through transformation from government ministries or bureaus while some were deliberately designed in the 1990s to shoulder bad assets for the creation of beautified publicly traded subsidiaries (Walter & Howie 2003). At present, the core companies through the vertical ownership structure controlling a large army of subsidiaries have become the largest companies in China. The core company through its central position in the network lays down the group's development plans and strategies, unifies group members' action, and coordinates the relationships among member companies.

Above the core company is an ownership supervision agency of the central or local government known as the State-Owned Assets Supervision and Administration Commission (SASAC), exercising controlling shareholder rights on behalf of the state. The core company is an ownership vehicle through which the state keeps direct or indirect control rights over a large number of SOEs. It plays a vertical coordination role between the state and group members that engage in actual production by transmitting policy downward from the government to member firms and information and advice upward to the state. As some Chinese commentators note, "The key sectors and backbone industries are still controlled by the state through wholly state-owned or state-controlled enterprises….In reality, the state can control the nationally important industries and key areas to lead the economy simply by grasping a few hundred large state-owned holding companies or business groups" (Zheng et al. 2009:2).

Despite their bigness in size and closeness with the state, the core companies to date have received little scholarly scrutiny, partly due to their low transparency. The core companies are organized as closely-held companies without disclosure obligations as publicly-traded companies do. Part of the dissertation, especially Chapters 2 and 3, is an endeavor to fill this void by exposing the inner governance of the core companies.

1.2.2 Listed Company

The facade of the Chinese state-owned business group is the listed company rather than the core company or a group of companies. The Chinese government's strategy in managing groups under its supervision has been to consolidate high-quality assets into specific companies and to seek public listing for those companies. There is usually one or more listed companies in the group. For example, PetroChina, one of the largest oil companies in the world, has shares listed on the Shanghai and New York Stock Exchanges and is the external face of the CNPC Group, the core company of which is the China National Petroleum Corporation. As of the end of 2010, the business groups under the Chinese central government's supervision controlled 336 listed companies, domestically and internationally.[9] These listed firms are the focus of most existing scholarship on Chinese corporate governance.

The listed company is one of the structural openings that connect the state ownership network to the non-state world. The listed company creates opportunities for non-state actors including international and private entities to participate in the SOE sector. The creation of such a structural opening serves multiple purposes. Besides raising capital, it is more intended to improve the governance quality of the SOEs through exposing them to higher corporate governance standards and market pressure, especially for the case of overseas listing.[10] The existence of the listed company may reduce the potential governance problems arising from complete closeness or over-embeddedness of the SOEs and hopefully diffuse positive effects throughout the ownership network. The existence of the listed company also serves political

[9] The Development and Reform Condition of the Central Enterprises in the 11th Five-Year Plan [i.e. 2006-2010] and the Principle Ideologies in the 12th Five-Year Plan [i.e. 2011-2015)

[10] In SASAC's Press Conference held in Nov. 30 2004, the then SASAC's chairman, Mr. Rongrong Li answered that "Why do we promote overseas listing? Our purpose is to make our enterprises walk on a road of more regulated corporatization and thereby have better corporate governance."

purposes: to gain international publicity for Chinese SOEs and to relieve the pressure of immediate mass privatization to the detriment of state control.

1.2.3 Finance Company

According to transaction cost economics, business groups in developing countries are a substitute for missing institutions including well-functioning capital markets (Leff 1978). Information asymmetry is an inherent problem in any financial system, and the problem is compounded by severe market imperfection which exists commonly in developing countries such as China. The trust and sustained relationships among group members can mitigate the information asymmetry problem as the close relationships permit thick and rich information communicated across firm boundaries. As a result, group members can accurately assess risks and allocate capital efficiently. Business groups function as an institution to mobilize pooled capital which extends beyond the resources of a single firm.

The Japanese *keiretsu* built around the main bank system presents the classic model of intra-group financing collaboration (Lincoln, Gerlach and Ahmadjian 1996). Although Chinese economic strategists indeed contemplated the Japanese main bank model in the formative period of China's business groups, the strategists ultimately decided to adopt a limited version of the main bank – the finance company. Three plausible reasons are advanced to explain why the Chinese policymakers shied away from an outright adoption of the Japanese main bank system. First, the industrial SOEs were already trapped in their own productivity problems and unlikely to have adequate skills to manage financial complexities and risks. Second, putting a bank in the business group would dilute and complicate the hierarchical governance structure under the core company and the centralized state supervision. Thus, constructing a finance company as a subsidiary controlled by the core company preserves the centralized hierarchical governance

order. Third, having a full-fledged financial institution in the business group might pose a competition threat to the state-owned commercial bank sector.[11]

The finance company is a non-bank financial institution that provides an expanding range of financial services for group members. Under the current regulations, a finance company essentially is a mini-hybrid of the commercial bank and the investment bank. A finance company, subject to the China Banking Regulatory Commission's approval, can accept member companies' deposits, lend money to member companies, provide loan syndication services, offer foreign exchange services, handle acceptances and discounts on negotiable instruments, act as a guarantor for member companies, engage in insurance agency business, assist payments between member companies, provide financing consulting services, conduct inter-bank loans, issue securities to the inter-bank bond market, underwrite group members' securities, engage in equity investment in financial institutions, engage in financial leasing, provide consumer loans related to member companies' products, and so on.

A significant advantage provided by the finance company is it breaks the inter-company lending prohibition in China.[12] The finance company acts as a hub linking the financial resources of member companies and realizes the collective financial power. Another advantage of having a finance company in the group is it opens a business channel into the financial sector. The industrial SOEs have been very interested in branching into the financial sector, but Chinese financial regulators have been cautious about their expansion due to the complexity of financial risk management. As the finance company can lawfully provide financial services to member

[11] The third reason was advanced by an Interview with the vice Chairman of China Business Group Association.
[12] The General Provisions of Lending, Article 61. The People's Bank of China has been considering an amendment to this restriction and gives companies an additional financial channel through inter-company lending. The People's Bank of China solicited a couple of times (in 2004 and 2010) comments on the proposed new rules. However, according to the statement made in January 21, 2011 by Mr. Xuedong Zhuo, the Chair of the Legal Affairs Department of the People's Bank of China, there is no timetable to adopt this amendment due to lots of controversy unsolved and it is unlikely to see such an amendment in a foreseeable time frame.

companies and invest in other financial institutes including banks, it acts as a learning device for industrial SOEs to acquit themselves with the services of the finance sector. In recent years, many state-owned business groups have used their finance companies to make connections with the financial sector. The connections with the financial sector through the finance company will be discussed in more detail in Chapter 4.

Not all Chinese business groups are eligible to set up a finance company, however. The China Banking Regulatory Commission promulgated a list of substantive requirements. Top on the list is the business group should be consistent with the Chinese government's industrial policies.[13] Unsurprisingly, most of the finance companies are affiliated with business groups in heavy industries or the SOE sector, as shown in [Table 1] and [Table 2]. Almost all of the largest finance companies are state-owned, and some are formidable in size, as shown in [Table 3]. The largest finance company in China is comparable in size (by assets) to the country's twentieth-largest bank. In addition, the business group should satisfy certain capital and profitability requirements in order to establish and maintain a finance company. Thus, small or unprofitable business groups are excluded from having a finance company, though the Chinese regulatory authorities have slightly relaxed these requirements. As of the end of 2011, there were 127 finance companies with 7,018 employees in China.[14]

[13] Measures for the Administration of Finance Companies of Business Groups, Item 1 of Article 7.
[14] China CBRC Annual Report (2011).

[Table 1]

The Industrial Distribution of Chinese Finance Companies, 2009

Industry	Number	Percentage
Electricity	14	14.9%
Military	10	10.6%
Electronics	8	8.5%
Transportation	7	7.4%
Coal	7	7.4%
Machinery	6	6.4%
Automobile Manufacturing	6	6.4%
Oil and Chemistry	6	6.4%
Steel	5	5.3%
Metals	5	5.3%
Construction Materials	2	2.1%
Trade	1	1.1%
Others	17	18.1%
Total	94	100.0%

Source: raw data collected from Almanac of Chinese Finance Companies (2010), compiled by author.

[Table 2]

Distribution of Chinese Finance Companies, 2009

Ownership Type	No. Company	Avg. Assets (million USD)	Avg. Net Assets (million USD)	Avg. Profits (million USD)
State-Owned under the Central Government	50	3,021	320	51
State-Owned under the Local Governments	31	996	153	14
Private	9	961	139	16
Foreign	4	481	77	4
Total	94	2,122	244	35

Source: raw data from Almanac of Chinese Finance Companies (2010), compiled by author. USD: RMB=1:6.83 (Dec. 2009)

[Table 3]

Top 10 Finance Companies in China, by Asset Size, 2009

Rank	Company Name	Year Est.	Assets (USD billion)	Affiliated Group's Industry	Bank with Comparable Assets Size (National Rank)	Controlling Owner (State / Nonstate)
1	China Petroleum Finance Co.	1995	40.87	Oil	Beijing Rural Commercial Bank (20)	State
2	China Power Finance Co.	2000	16.46	Electricity	Shengjing Bank (36)	State
3	Sinopec Finance Co.	1988	8.31	Oil	Bank of Hebei (52)	State
4	China Shipbuilding Industry Finance Co.	2001	6.85	Shipbuilding	Bank of Nanchang (57)	State
5	SAIC Finance Co.	1994	6.43	Automobile	Bank of Qingdao (58)	State
6	China Aerospace Science & Tech. Finance Co.	2001	4.56	Aerospace	Bank of Weifang (79)	State
7	CNOOC Finance Co.	2002	4.44	Oil	Qishang Bank (82)	State
8	Haier Group Finance Co.	2002	3.64	Home Appliances	Kushan Rural Commercial Bank (93)	Nonstate
9	China Power Investment Financial Co.	2005	3.55	Electricity	Chang'An Bank (95)	State
10	WISCO Finance Co.	1993	3.27	Steel	Bank of Jujiang (96)	State

Source: Raw data from Almanac of Finance Companies of Chinese Business Groups (2010 Edition), compiled by author. The exchange ratio of RMB to USD is 6.83:1

The regulatory control suggests that Chinese finance companies are not a pure-market substitute that exists simply to fill the institutional void as explained by transaction cost economics. The market-substitute-explanation appears inadequate as most of the finance companies exist in state-owned business groups that have easy access to the major state-owned banks rather than in private business groups that really need alternatives to banks. The finance company seems to be more of an *additional* rather than *substitute* vehicle for state-owned business groups to manage financial resources. Furthermore, the regulatory requirements raise questions about the causality between the existence of a finance company and the economic performance of the business group. Based on transaction cost theory, Keister (1998) argued and found that Chinese business groups with a finance company performed better economically than those without one. This transaction cost approach, however, might suffer the problem of reverse causality as the eligibility to establish and continuously own a finance company is strictly limited to financially good business groups.

1.2.4 Research Institute

Chinese policymakers have encouraged business groups to include research institutes as members to promote high technology development and increase international competitiveness. Most of the national business groups contain one or more research institutes. For example, the Sinopec Group, one of the largest oil groups in China, comprises nine research institutes. The research institutes conduct R&D, with particular emphasis on applied research in areas related to the group's products and production processes. They are the major patent producers for other member companies. Often, the research institutes collaborate with universities on particular projects to derive complementarities between the applied focus of business R&D programs and the theoretical approach of academic researchers. Some research institutes also offer graduate-

degree awarding programs approved by the state. [Table 4] shows the employment information and activities of the Sinopec research institutes. Their activity in patent applications made Sinopec one of the top ten patent filers in China.[15]

[Table 4]
Research Institutes of the Sinopec Group

Sinopec Group	Domestic Patent Applications	Domestic Patents Approved	Int'l Patent Applications	Int'l Patents Approved	Employees	Professional Technicians & Engineers & Researchers	PhD & Master Degree Awarding
Sinopec Research Institute of Petroleum Processing	1,333	866	254	152	1,320	1026	Yes
Sinopec Fushun Research Institute of Petroleum and Petrochemicals	930	584	18	27	711	446	No
Sinopec Qingdao Safety Engineering Institute	31	18	0	0	400+	--	No
Sinopec Research Institute of Petroleum Engineering	47	10	2	0	249	--	No
Sinopec Beijing Research Institute of Chemical Industry	608	310	151	76	822	658	No
Sinopec Shanghai Research Institute of Petrochemical Technology	921	544	85	30	621	500+	No
Sinopec Exploration & Production Research Institute	102	1	46	4	1,037	736	No
China Petrochemical Technology Company	--	--	--	--	--	--	No
Sinopec Geophysical Research Institute	--	--	--	--	--	--	No

Note: raw data collected from China Petrochemical Corporation Yearbook (2010), compiled by author. The patent data for Sinopec Research Institute of Petroleum Process only cover the years from 2005-2009.

Typically established as not-for-profit institutions, the research institutes receive funding from their holding company (usually the core or the listed company) in the group. Research institutes in groups with a diverse range of products may be multilayered, with a chief institute affiliated with the core company or the listed company and second-tier institutes established under particular operating subsidiaries. Intellectual property arising out of the research activities

[15] State Intellectual Property Office of China, Annual Report of Patent Statistics [《专利统计年报 2009》]

is typically owned by the holding company or allocated by contract in joint projects with outside institutes.

1.2.5 Internal Structure and Governance of the Business Group

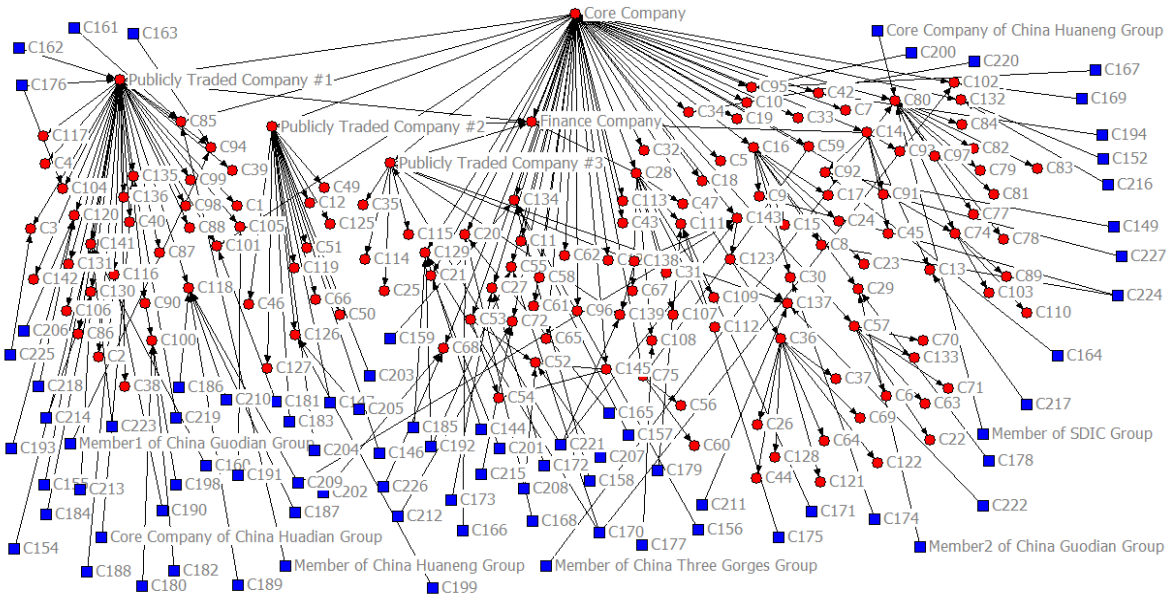
The major actors and a large number of subsidiaries related to the production chain form a vertical ownership network with the core company at the top of the corporate hierarchy. Unlike the extensive cross-shareholding found in the Japanese business groups, cross-shareholding is very rare in the Chinese state-owned business groups. The top-down ownership structure in part reflects a legacy of the old administrative system governing the SOEs. Some of the core companies were former government ministries or bureaus and their subsidiaries were the old SOEs supervised by the ministries or bureaus. This vertical ownership structure facilitates the state's centralized control through the core companies.

Internal group-governance structures are specified in legally binding agreements called articles of grouping, which are adopted by all group members. The articles of grouping are state-supplied, standard form contracts required for all registered business groups, and their specific provisions are largely composed of default rules. In reality, the core company dictates the terms of the articles, and the internal governance rules grant the core company veto rights and other enhanced governance rights with respect to the group. Many articles of grouping provide for plenary or management bodies to facilitate group or delegated decisionmaking, respectively, but these organs typically either have only advisory power or are structured so that the core company effectively controls their decision-making processes. In short, the governance of a Chinese business group is a largely top-down process but it is open to information and participation from below.

This section uses two examples to demonstrate the intra-group network structure and governance. China Datang Group represents the SOEs at the national level while Yudean Group for those at the local level. These two examples nicely illustrate the vertical network common in major Chinese SOEs today.

China Datang Group is a state-owned business group under the Chinese central government's supervision. The core company of the group is China Datang Corporation, a Fortune Global 500 company and one of the five largest power-generation companies in China. [Figure 6] shows the ownership structure of the group, which is comprised of 143 companies. Note the layered structure, which features a core holding company at the top and layers of subsidiaries directly or indirectly controlled by the holding company below. Also note the top-down nature of the ownership structure and a nearly complete absence of cross shareholding among group member companies. The Group includes three publicly listed companies controlled by the holding company. These include Datang International Power Generation Corporation (Publicly Traded Company #1 in the Figure), the shares of which are listed on the Hong Kong Stock Exchange and the London Stock Exchange. Another key member is the finance company, also controlled by the core company but with some shares held by the publicly listed companies.

[Figure 6]
Ownership Structure of Datang Group, 2009

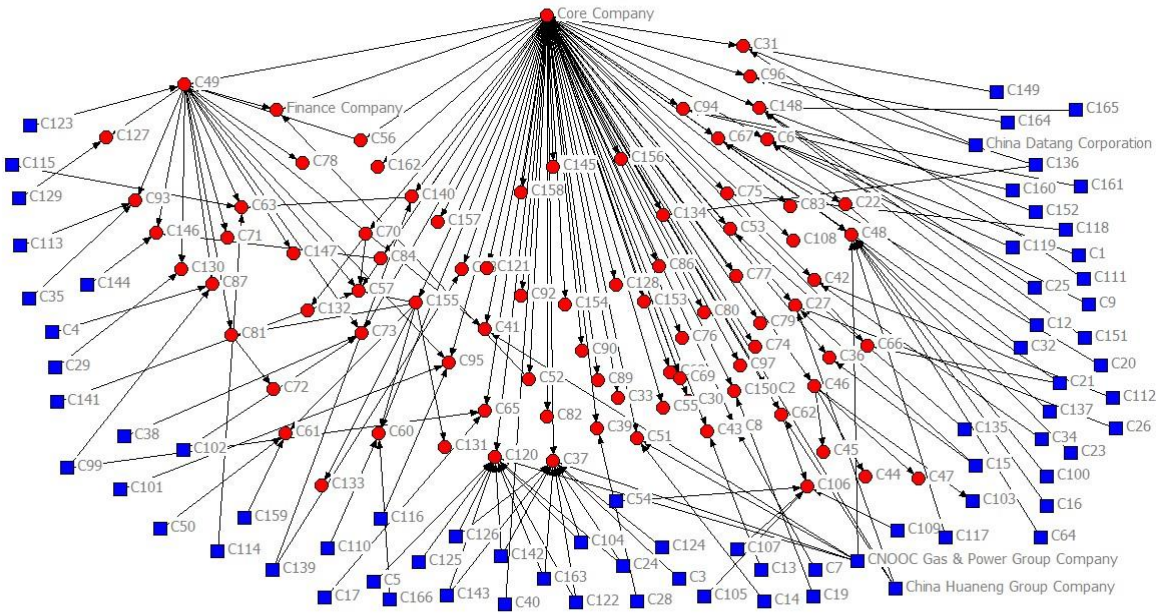


Source: raw ownership data hand collected from Yearbook of China Datang Group (2009 Edition).
Note: The red circles indicate member companies in China Datang Group; the blue squares indicate non-member companies. There are 143 member companies and 84 non-member companies in the figure. The black ties with arrows indicate ownership direction. For example, X →Y means X Company has an ownership stake in Y Company. There are 248 ownership connections in this graph.

The vertical ownership network structure is also typical for business groups under the control of the local governments. [Figure 7] illustrates the ownership network of Yudean Group, a business group controlled by the provincial government of Guangdong Province. Guangdong Yudean Group Company is the core company, which is one of the largest 500 enterprises in China and the ninth largest in the Chinese power industry. Similar to the network structure of China Datang Group, the core company of Yudean Group occupies the central position in the network and it has direct ownership stakes in 66 member companies. The group has only one publicly traded company, Guangdong Electric Development Company (C49 in the Figure), whose shares are listed on the Shenzhen Stock Exchange. The publicly traded company has direct ownership stakes in 16 other member companies. Yudean Group also includes a finance

company, which is owned by the core company and two other member companies (C49 & C52). The finance company itself does not hold any ownership stake in any other member companies. Overall, the ownership structure of Yudean Group is a highly centralized network revolving around the core company rather than a distributed network comprised of extensive cross-shareholding among member companies.

[Figure 7]
Ownership Structure of Yudean Group, 2010



Source: raw data collected from the official website of Guangdong Yudean Group Company, the 2010 prospectus of Guangdong Yudean Group Company and 2010, 2009 annual reports of Guangdong Electronic Development Company.
Member companies are marked as red round nodes; non-member companies are blue square nodes. There are 162 companies in this graph, including 87 member companies and 75 non-member companies.
The ties in this graph are directional. If X company has an ownership stake in Y company, then X →Y.

According to Yudean Group's articles of grouping, the legally-binding agreement on internal governance, the purposes of the group are to implement the economic development policies of the Guangdong government, to facilitate efficient allocation of resources, and to eventually become a domestically first-rate and internationally competitive business group in the energy industry. While the articles of grouping allow membership based on contractual relations to the group, in reality membership are all based on shareholding relations.

In order to coordinate members, Yudean Group sets up a general assembly composed of representatives of all member companies in the group. The general assembly meets once a year and is the ultimate coordination institution of the group. The major responsibilities of the general assembly are to research the group's development strategies, amend the articles of grouping, and vote on the matters proposed by the executive committee of the group. Because the general assembly only meets once a year, the executive committee undertakes the responsibilities of managing the group's ordinary affairs. The executive committee is comprised of all the board members of the core company. The major responsibilities of the executive committee include laying down the group's development plans and strategies, unifying group members' action, coordinating the relationships among member companies, protecting the group's and member companies' interests, granting or terminating membership, and any other matters delegated by the general assembly. The executive committee does not maintain an independent management system to implement its decisions but utilizes the management departments of the core company. Such legal design essentially merges the group's governance institution with the core company. The governance power of the group is thus centralized in the core company.

1.2.5 Characteristics, Governance and Performance

A typical research question regarding the business group organization is how group affiliation affects firm performance (e.g., Khanna & Rivkin 2001 for group affiliation effects in 14 developing countries; Lincoln, Gerlach & Ahmadjian 1996 for Japan; Kim& Yi 2006 for Korea). The prevailing explanation for the relationship between group affiliation and firm performance is based on the transaction cost theory in which business groups arise as a substitute for missing institutions, including capital, product, human resources, technology market institutions (Leff 1978; Chang and Choi 1988; Khanna and Palepu 1997, 1999, 2000). The transaction cost approach predicts that business groups enjoy better economic performance when market institutions are weak but the superior performance will decline and eventually disappear when institutional environments get improved. Existing empirical evidence in China seems consistent with the transaction cost theory. Based on a sample of 1,119 publicly-listed Chinese companies, Ma et al. (2006) find that the interaction of business group affiliation and state ownership has a significant and positive effect on firm performance. Based on a sample of more than 400 publicly-listed Chinese companies in the period of 1999-2004, Carney et al. (2009) also find that affiliation with a business group improves performance but the value of group affiliation declines over time as the market institutions get mature.

As explained in the previous sections, the publicly-listed firm is only one type of major actors embedded in the vertical business network. While existing research has provided some insights into the group affiliation effects on the listed company's performance, it remains unclear how the business network would affect the behavior and performance of the core company, the central coordinator in the vertical network and the immediate portal through which the state-owner can reach the publicly-listed subsidiaries. The core company's performance, which is

presented as the consolidated financial statement of the core company itself and its controlled subsidiaries, provides a window to the assessment of the overall group performance in relation to the business group structure.[16]

In recent years, the state-owner has introduced many measures to modernize core companies. One of the important reforms is to experimenting with the board of directors as a monitoring device. Does the board of directors as a new governance institution improve the core company's performance? The state-owner also has used the listed company as a governance improvement strategy. It expects the listed company, especially the overseas listed one which is subject to higher corporate governance standards, can diffuse positive governance effects to other members in the business network. Thus, does the existence of a listed subsidiary, especially an overseas listed one, in the business group improve the core company's performance? Moreover, does the core company as the controlling shareholder of the finance company benefit from having such financial management device in hand? Also, since the core company is immediately owned and managed by the central or local government, do the institutional quality of the central or local government affect the core company's performance? Extant evidence shows listed subsidiaries controlled by local-government-owned core companies are more likely to be expropriated by their parents (Cheung, Rau, and Stouraitis 2010). It implies core companies (and groups) owned by local governments may have poorer corporate governance and consequently inferior performance than those owned by the central government. Alternatively, the core companies owned by the central government may perform better because the central government is more likely to retain control of better firms while the local governments keep less important and less efficient firms.

[16] According to SASAC's financial regulations, the core company's financial statement is the combined financial statement of the core company itself and its controlled subsidiaries.

Finally, do groups presenting a stylized model in which all the key actors (a core company, a finance company, a listed firm and a research institute) exist in the group have better financial performance than those that fall short of the model? Theoretically, the stylized model appears to offer great competitive advantages. It has a core company that may coordinate a large number of member companies to achieve planned goals and transmit advice to the government through its close ownership tie with the state. The listed company may give the group visibility and expose it to higher corporate governance standards. The finance company may provide additional financial management tools to deploy resources and diversify risks. The research institute may improve the group's production technologies and gain competitive edges. The ideal advantages however are conditioned by institutional realities. While the core company may have access to government decisionmakers, it may be vulnerable to undue state intervention. The listed company is expected to comply with higher corporate governance standards, but the Chinese capital market regulators remain ineffective in implementing the rules. The finance company itself may be a source of governance problem as there is meager regulatory oversight in China's shadow banking system (Zhang 2013). Finally, while many research institutes of the state-owned business groups are top filers of patent applications in China, the patent quality generally remains low (Xinhua 2013, Economist 2010). As a result, the efficiency of the stylized model may be ambivalent in practice.

1.2.5.1 Data and Methods

To evaluate the relationships between group features and performance, this chapter examines the largest state-owned business groups in China as of 2010, according to the annual ranking of the China Enterprise Confederation and China Enterprise Directors Association. Of the 500 largest enterprises, 302 were non-financial SOEs.

Ordinary least squares regressions will be used to analyze the relationships between group features and performance. The dependent variables are return on assets (ROA) and return on sales (ROS) of the group (essentially the consolidated performance of the core company and its controlled subsidiaries). The financial data are collected from the China Enterprise Confederation and China Enterprise Directors Association. The independent variables include various group features. For the core company, it examines whether the core company is owned by the central or local government (central=1, local=0) and whether the core company has set up the board of directors (yes=1). For the listed company, it examines whether the group has any listed company (yes=1) and whether the group has listed shares overseas (yes=1). It also includes variables regarding whether the group has a finance company (yes=1) and whether the group has any research institute (yes=1). Furthermore, two variables are created to evaluate whether groups presenting the stylized model where all the key actors exist in the group perform better than those that fall short of the full model: (a) *Stylized Model 1* indicates the group has a core company, a listed company, a finance company and a research institute; and (b) *Stylized Model 2* indicates the group has a core company, an overseas listed company, a finance company and a research institute.

In addition, (log) number of employees is included as a control variable to account for firm size. Since the profitability of Chinese SOEs has been seriously criticized for their heavy reliant on monopoly power and government favorable treatment, it is expected that Chinese SOEs operate in a more liberalized market would have less impressive performance. This chapter uses China's NERI Marketization Index (2009) developed by Gang Fang et al. (2011) to assess the institutional environment where an SOE is headquartered. The marketization index measures the marketization process of each province or municipality based on a combination of objective

market reform indicators and large-sample business surveys. Finally, prior year performance is included as a lagged dependent variable.

1.2.5.2 Results and Analysis

[Table 5] gives a summary of the descriptive statistics. It shows that 27.5% of the 302 non-financial SOEs are owned by the central government; 81.5% of the SOEs have set up the board of directors in the core company; 80.5% have at least one listed company; 18.5% have listed shares overseas; 27.5% have a finance company in the group; and 56.3% have at least one formal research institute. While all the state-owned groups contain some key actors, only 18.2% present a full-fledged model (Stylized Model 1) and only 8.3% for Stylized Model 2. The average revenues of the SOEs are approximately 88.8 billion RMB (13.4 billion USD) and the average number of employees is around 70,000. The average ROA and ROS are around 3-4%. The average institutional quality of the SOE's headquarters locations is 8.962 with a minimum at 3.25 and a maximum 11.8, according to China's NERI Marketization Index.

[Table 5]
Descriptive Statistics Summary (2010)

Variable Name	Number of Observations	Mean (Standard Deviation)
Group Organizational Structure		
Owned by Central Government	302	.275 (.447)
Core Company Having Board of Directors	302	..815 (.389)
Having a Listed Company	302	.805 (.397)
Having an Overseas Listed Company	302	.185 (.389)
Having a Finance Company	302	.275 (.447)
Having a Research Institute	302	.563 (.497)
Stylized Model		
Having Core Company + Listed Company + Finance Company+ Research Institute	302	.182 (.387)
Having Core Company + Overseas Listed Company + Finance Company+ Research Institute	302	.083 (.279)
Group Size and Performance		
Revenues	302	8,876,942 (10,000 RMB) (1.86e+07)
Employees	298	71,328 (159,914)
ROA (2010)	299	3.679 (3.578)
ROS (2010)	299	4.127 (5.071)
ROA (2009)	263	3.293 (3.260)
ROS (2009)	263	4.033 (4.768)
Headquarters' Location		
Institutional Quality Index	302	8.962 (1.714)

While one may assume that larger SOEs tend to encompass all types of the key actors, [Table 6] shows that revenues and the number of employees are weakly correlated with the existence of a finance company, a research institute or an overseas listed company. Moreover, while the SOEs under the central government's control tend to have more economic significance, there is only a moderate positive correlation between central government ownership and the existence of the stylized model. In other words, the stylized model is applicable both to the national and provincial groups.

[Table 6]
Correlations

	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)	(N)	(O)
Phi Coefficient															
Owned by Central Government (A)	1.000														
Having Board of Directors (B)	-.546	1.000													
Having a Listing Company (C)	.098	.023	1.000												
Having an Overseas Listed Company (D)	.451	-.255	.235	1.000											
Having a Finance Company (E)	.385	-.260	.247	.279	1.000										
Having a Research Institute (F)	.333	-.163	.121	.249	.169	1.000									
Stylized Model 1 (G)	.401	-.305	.232	.327	.767	.416	1.000								
Stylized Model 2 (H)	.380	-.321	.148	.630	.488	.265	.636	1.000							
Point-Biserial Coefficient/ Pearson Correlation Coefficient															
Revenues (I)	.378	-.199	.046	.292	.294	.217	.303	.343	1.000						
Employees (J)	.327	-.236	-.007	.223	.222	.183	.198	.230	.800	1.000					
ROA (2010) (K)	-.100	-.071	-.025	.012	-.063	-.064	-.031	.032	-.028	-.116	1.000				
ROS (2010) (L)	.021	-.021	.046	.087	.096	-.042	.025	.081	-.022	-.029	.590	1.000			
ROA (2009) (M)	-.115	.013	-.054	.022	-.108	-.045	-.051	-.006	-.023	-.108	.869	.490	1.000		
ROS (2009) (N)	.056	-.010	.035	.152	.088	-.073	.034	.071	-.005	-.029	.532	.845	.629	1.000	
Institutional Quality Index (O)	.258	-.078	.036	.122	.045	-.007	.058	.080	.119	.042	.012	.007	.020	.055	1.000

[Table 7] shows the results of the relationships between group features and financial performance. Contrary to the hypothesis that SOEs under the central government's control would have better financial performance, the results here show that the central government owned SOEs have worse performance, albeit not statistically significant. Neither the existence of the board of directors in the core company has positive effects on ROA or ROS. It requires

further investigation regarding why the board of directors as an instrument to modernize the SOEs does not deliver what it is expected to give (see discussion in Chapter 2).

The effect of having a listed subsidiary, whether overseas listed or not, is ambiguous. It is positively associated with ROA but negatively with ROS. The effect of a research institute is also unclear, negative on ROA and positive on ROS. Having a financial company has positive effects both on ROA and ROS. All these results are statistically insignificant, however. [Table 7] also shows that groups presenting the full-fledged stylized model appear to perform better than those that fall short of the full model; nevertheless, the effect is statistically significant only on ROA and only when the group has shares listed overseas ($b=.750$, $p<.05$).

For control variables, both the number of employees and location institutional quality are negatively, albeit statistically insignificant, associated with financial performance. The result of location institutional quality suggests the competitive advantages of the SOEs might be undercut when the market becomes more liberalized. The regression models in [Table 6] do not have the problem of heteroskedasticity.

[Table 7]
Group Features and Performance, with Lagged Dependent Variable

	Performance							
	ROA				ROS			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Core Company								
Central/Local	-.482	-.605	-.468	-.498	-.546	-.440	-.323	-.391
	(.305)	(.316)	(.300)	(.299)	(.514)	(.528)	(.503)	(.502)
Board of Directors	-.473	-.424	-.425	-.386	-.094	-.117	-.131	-.062
	(.303)	(.302)	(.304)	(.304)	(.511)	(.508)	(.512)	(.513)
Listed Company								
Yes=1	.448				-.138			
	(.297)				(.502)			
Overseas =1		.360				-.369		
		(.288)				(.488)		
Finance Company	.436	.471			.509	.512		
	(.247)	(.245)			(.418)	(.413)		
Research Institute	-.005	-.033			.504	.534		
	(.224)	(.225)			(.381)	(.383)		
Stylized Model 1			.388				.135	
(Core Company + Listed Company + Finance Company+ Research Institute)			(.282)				(.474)	
Stylized Model 2				.750*				.682
(Core Company + Overseas Listed Company+ Finance Company + Research Institute)				(.377)				(.637)
(Log) Number of Employees	-.074	-.059	-.028	-.023	-.079	-.073	-.010	-.022
	(.093)	(.092)	(.088)	(.086)	(.157)	(.154)	(.148)	(.145)
Prior Year Performance	.888***	.884***	.884***	.881***	.904***	.908***	.902***	.900***
(Lagged Dependent Variable)	(.032)	(.032)	(.032)	(.032)	(.036)	(.036)	(.036)	(.036)
Location by Institutional Quality	-.013	-.012	-.011	-.013	-.062	-.059	-.074	-.075
	(.062)	(.062)	(.062)	(.062)	(.105)	(.105)	(.105)	(.105)
Constant	1.555	1.713	1.457	1.426	1.806	1.628	1.482	1.551
	(1.124)	(1.137)	(1.129)	(1.119)	(1.875)	(1.890)	(1.876)	(1.862)
Observations	258	258	258	258	258	258	258	258
R^2	.769	.768	.765	.767	.720	.712	.717	.718

The table presents unstandardized coefficients with standard errors in parentheses.
* p < .05

To double-check the above findings, differences in ROA (current year ROA minus prior year ROA) and differences in ROS (current year ROS minus prior year ROS) are used as alternative dependent variables. [Table 8] reports the results. The findings are very similar to [Table 7]. Note that the existence of a finance company has a statistically significant effect on ROA in Model 10, but not in other models. Also note that all the coefficients of the stylized models are positive but insignificant.

[Table 8]
Group Features and Performance, with Δ ROA and Δ ROS as Dependent Variables

	Performance							
	Δ ROA				Δ ROS			
	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Core Company								
Central/Local	-.389 (.311)	-.483 (.321)	-.364 (.306)	-.385 (.305)	-.600 (.519)	-.444 (.535)	-.367 (.510)	-.425 (.508)
Board of Directors	-.404 (.309)	-.353 (.308)	-.359 (.311)	-.324 (.312)	-.129 (.516)	-.155 (.513)	-.161 (.518)	-.103 (.520)
Listed Company								
Yes=1	.462 (.304)				-.149 (.508)			
Overseas =1		.264 (.293)				-.541 (.488)		
Finance Company	.472 (.252)	.517* (.251)			.429 (.422)	.447 (.417)		
Research Institute	-.021 (.229)	-.043 (.231)			.609 (.384)	.647 (.384)		
Fitness to Stylized Model 1 (Listed Company + Finance Company+ Research Institute)			.372 (.288)				.117 (.480)	
Fitness to Stylized Model 2 (Overseas Listed Company+ Finance Company + Research Institute)				.683 (.386)				.582 (.644)
(Log) Number of Employees	-.047 (.095)	-.025 (.093)	005 (.090)	.010 (.088)	-.090 (.158)	-.076 (.155)	-.019 (.150)	-.028 (.147)
Location by Institutional Quality	-.025 (.063)	-.023 (.064)	-.024 (.064)	-.026 (.063)	-.075 (.106)	-.070 (.106)	-.088 (.106)	-.090 (.106)
Constant	.914 (1.135)	.996 (1.147)	.766 (1.140)	.716 (1.130)	1.669 (1.897)	1.409 (1.908)	1.346 (1.899)	1.402 (1.886)
Observations	258	258	258	258	258	258	258	258
R^2	.036	.030	.016	.021	.021	.025	.007	.010

The table presents unstandardized coefficients with standard errors in parentheses.
* $p < .05$

Overall, the stylized model which appears to have governance, financial and technology advantages does not render superior performance. Two complementary explanations might be offered. The first is the key actors themselves do not have adequate capacity to realize the proposed advantages. For example, the listed company itself does not have good corporate governance and therefore cannot diffuse positive effects to the group. Similarly, the research institute itself does not produce high quality patents and thus generates little benefits to the group. Second, collaborative relations among the key actors may not exist or function properly. For instance, the listed company itself may have good governance practices but restricted interaction with other group members and, as a result, it does not diffuse good practices in the group. Due to the unavailability of comprehensive data on the internal relations among member firms of the state-owned groups, it is difficult to empirically confirm this speculation.

1.2.6 Beyond the Focal: Intergroup Networks

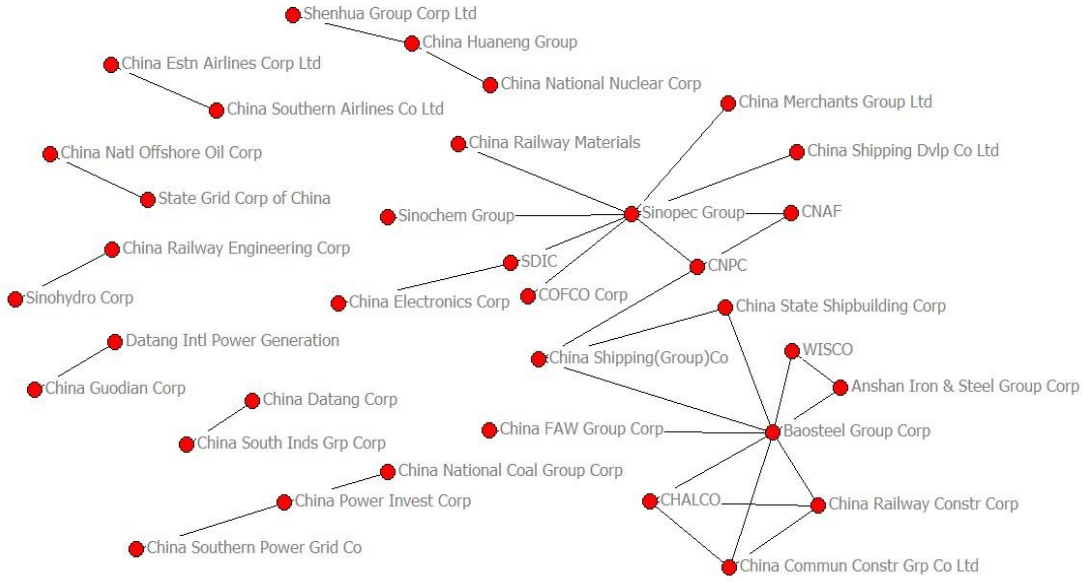
While a large state-owned group in China is typically structured as a vertical network of ownership relations, the group itself is not an isolated network but with collaborative linkages with other groups. Although groups in the same industry do compete domestically, they have been encouraged by the state to collaborate in overseas projects to increase their global competitiveness. These collaborative linkages typically take two forms: equity joint ventures and contractual strategic alliances. These linkages, often among groups in complementary industries, are designed to facilitate technological development and a host of other objectives, such as information sharing, marketing, and pooling of capital for capital-intensive projects.

To assess the intergroup relations, I collected data on joint ventures and strategic alliances among the national industrial groups under the control of the State-Owned Assets Supervision and Administration Commission (SASAC) of the central government. The central SASAC is the agency that manages the most important SOEs in China (detailed discussion in Chapter 2). As of the time of data collection, there were 117 SOEs under the central SASAC's supervision. The joint ventures and strategic alliances of the 117 SOEs were collected from SDC Platinum Database, one of the most commonly used sources regarding global joint ventures and strategic alliances. The deals took place in the period of 2003-2011.

[Figures 8 & 9] illustrate the use of both ownership and contract to construct intergroup networks among the industrial business groups under the control of the Chinese central government. The number of the inter-group collaborative relations in reality is much greater than presented in the Figures as SDC Platinum Database is focused more on international than domestic deals. The Figures show that such collaborative linkages are constructed among both complementary groups and groups comprised of erstwhile direct competitors. In most

economies, these forms of collaboration would raise obvious antitrust concerns. China has an Antitrust Law, enacted in 2008, that, as a formal matter, would appear to subject these alliances, along with mergers and other combinations between SOEs, to antitrust scrutiny. In practice, however, the SOEs have thus far been virtually exempt from antitrust enforcement.[17]

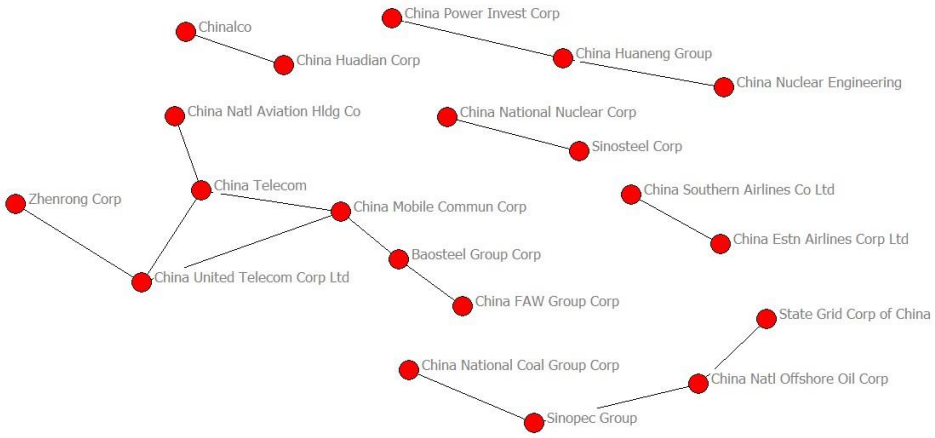
[Figure 8]
Joint Venture Network Among the Industrial Business Groups Controlled by the Chinese Central Government, 2003-2011



Data Source: raw data manually collected from SDC Platinum M&A Database. When two business groups have set up at least a joint venture together, there is a link between the two groups.

17. The only major exception to date is an antitrust investigation into abuse of dominance of the domestic broadband market by China Telecom and China Unicom, but the investigation ended up with no further government action. Despite SOEs' size and active role in mergers and acquisitions, very few merger rulings, to date, involve SOEs. Zhang (2011).

[Figure 9]
Strategic Alliance Network among the Industrial Business Groups Controlled by the Chinese Central Government, 2003-2011



Data Source: raw data manually collected from SDC Platinum M&A Database. When two business groups have set up at least a strategic alliance together, there is a link between the two groups.

The ownership network of China Datang Group, as previously shown in [Figure 6], shows the details of the equity linkages across the business groups under the control of the central government. Eighty-four nonmember companies have equity relations with group members. Some of these nonmember companies are the core companies or affiliates of other major state-owned groups in the related or complementary industries, including Guodian Group, Huadian Group, Huaneng Group, and Three Gorges Group. [18]

The inter-group linkages are constructed not only between the national groups (i.e. groups controlled by the Chinese central government) but also between national and local groups (i.e. groups controlled by the Chinese local governments). The ownership network of Yudean Group, as earlier shown in [Figure 7], nicely illustrates the central-local intergroup linkages. The

18. In 2002, the Chinese government reorganized the national power industry. National Power Corporation, which controlled half the power generators and all of the power grids in China, was dissolved, and its assets were divided into eleven business groups under SASAC supervision. Datang is one of the power-generation companies created in the reorganization. *See* HENGYUN MA & LES OXLEY, CHINA'S ENERGY ECONOMY: SITUATION, REFORMS, BEHAVIOR, AND ENERGY INTENSITY 129 (2012).

provincial group has equity connections with the core or member companies of other national business groups in the related or complementary industries, such as China Datang Group, China Huaneng Group, and CNOOC Group. These central-local linkages are the result of an evolving dynamic between the central and local governments. Initially, local governments sought investment from the national groups to rescue moribund local SOEs. As the national groups expanded, local governments began to view them as competitive threats to local businesses. Local protectionism increased, and a push was made to create "provincial champions". The relationship between national and local groups appears to be in flux again because of the global financial crisis, which prompted renewed central-local cooperation. The local governments now view the national champions as sources of support for small and midsize enterprises, which suffered when they lost the backing of foreign and private companies.[19] For the national groups, which are under pressure from their governmental supervisors to grow, tie-ups with local groups are an avenue of expansion.

19. As an example of the importance provincial governments are now placing on tie-ups with national groups, over a one-month period in 2011, the Guangdong provincial government reached 249 collaboration agreements, representing a total investment of $40 million, with 71 national groups. *See* Li Peng (李鹏), Yangqi ru Yuechao (央企入粤潮) [*The Influx of the Central SOEs into Guangdong*], ECON. & NATION WKLY. (Apr. 5, 2011, 8:04 AM), http://msn.finance.sina.com.cn/gdxw/20110405/080431242.html.

CHAPTER 2

POLITICAL NETWORKS, CONTROL MECHANISMS AND OBSCURITIES

Introduction

Obviously, as SOEs are owned by the state, they are connected to the government. But this inference over-simplifies the density and complexity of the Chinese SOEs' connections with the state system. The Chinese large SOEs are embedded in multiple types of specific ties with various government organs under the canopy of the Chinese Communist Party.

Along the ownership ties, the major formal connection through which the state exercises equity control rights is the State-Owned Assets Supervision and Administration (SASAC) of the central or local governments. Dissecting the SOEs' relation with SASAC reveals how information flows between the government and the SOEs, how the top managers of the SOEs are evaluated, appointed and compensated, and how the assets and profits are transferred in and out of the state system. The anatomy of the SOEs' relation with SASAC also shows involvement of multiple hidden but powerful governmental strings attached to the SOEs. The Chinese Communist Party, supervisory bureaus and political assemblies all have institutionalized practices such as personnel exchanges that tie the SOEs to themselves. The state's control network created through such multiple connections with SASAC and other government organs is largely invisible in the Chinese company law or securities regulations to which most scholars of Chinese corporate governance pay attention. The comprehensive embeddedness in the state system makes the SOE governance often diverge from the expected standards in the formal laws. This chapter particularly uses executive compensation as an example to show how the business

network structures and the various relations with the government organs work together to mask the actual governance of China's large SOEs.

2.1 Systematic Connections to the Party and Other Political Organs

The Communist Party of China as the single ruling party has its tentacles reaching into every important institution in China. Despite many reforms over the years to grant more management autonomy to the SOEs, the Party's grip on the SOEs remains strong and unshakable. The Party has institutionalized a number of ways in constructing systematic organizational connections to the SOEs. One particular way to make the organizational connections is to establish and strengthen the party committees and party organs in the SOEs. As a result, all Chinese SOEs have two parallel systems in personnel management: the regular corporate management system and the party system. In the corporate management system, positions are similar to those commonly found in firms elsewhere and include CEO, vice CEO, chief accountant, and if the company has a board of directors, a chairman and independent board members. A leadership team in the party system includes the secretary and several deputy secretaries of the party committee, and a secretary of the discipline inspection commission (an anticorruption office), along with other members of the party committee. Institutionalizing party penetration of corporate roles is formal policy, and overlaps between the two systems appear rather uniform, such that a corporate manager of a given rank typically holds a position of equivalent rank in the party system.[20] The interlinking between the corporate and party

[20] In 2004, the Organization Department of the Chinese Communist Party and the Party Committee of SASAC released Guanyu Jiaqiang he Gaijin Zhongyang Qiyedang Jian Gongzuo de Yijian [Opinions Concerning Strengthening and Improving the Party Construction Work in the Central Enterprises] (promulgated by the Org. Dep't Communist Party of China & Party Comm. SASAC, Oct. 31, 2004). A key principle of the Opinions is the policy of "bilateral entries and cross appointments." Bilateral entries means that members of the Party Committee can serve on the board of directors, the supervisory board, and the top management team, while board members and top managers who are party members can join the Party Committee. Cross appointments means that, if the company has a board of directors, the secretary of the Party Committee and the board chair can be assumed to be the same

leadership teams is intended to ensure the corporate decision-making always consistent with the party's policy.

The Party's penetration into the SOE system reaches not only to the core companies but also all the controlled subsidiaries, and not only at the top management level but also throughout the corporate hierarchy. As of the end of 2009, more than three million of the 9.36 million employees of the central SOEs were party members.[21] Furthermore, the Party is now planning to launch party committees in the SOEs' foreign joint ventures in order to ensure its influence over the SOEs would not be diluted by foreign exposure.[22]

The party leadership committee is a unique feature of Chinese corporate governance. According to the Constitution of the Chinese Communist Party, a main function of the party organs in an SOE is to "participate in decision making on the enterprise's major matters."[23] The major matters include, but not limited to: the enterprise's development strategies, mid- and long-

person. If the company does not have a board of directors, then the secretary of the Party Committee can be assumed to be the CEO, and the vice-CEO can be assumed to be the deputy secretary of the Party Committee.

[21] China's State-Owned Assets Supervision and Administration Yearbook (2010).

[22] Dongfeng Motor Company Limited (Dongfeng JV), the largest Sino-foreign joint venture in China's domestic automobile industry, is a prominent case. Dongfeng Motor Company Limited was established in 2006 as a 50/50 joint venture between Nissan Motors and Dongfeng Motor Corporation (the core company of Dongfeng Group), a large SOE under the central SASAC's supervision. Nissan Motors initially refused to include in the joint venture's articles of association any formal recognition for the party involvement. After nine months of negotiation, Nissan Motors conceded. As a result, the joint venture's articles of association include provisions which formally recognize the establishment of party organs within the joint venture and its subsidiaries and require the joint venture to provide personnel, monetary and material supports to the operation of the party organs. Moreover, the Dongfeng core company and Nissan Motors signed a memorandum regarding the operation of the party organs in the joint venture, which specified that the number of the party organ staff should be 0.6 percent of the joint venture's total employees; the party operation budget should be equivalent to 0.6 percent of the joint venture's total employee wages; and the leaders of the party organs should enjoy the same benefits as the top corporate managers of the equivalent level. At present, the joint venture has over 800 party organs with more than 700 full-time staff members serving over 13,000 party-employees. The institutionalization of party penetration in Dongfeng JV is acclaimed and promoted by the central Party Organization and SASAC. See Research Reports on Dongfeng Corporation Party Committee's Participation in the Important Decisionmaking of Joint Ventures [关于东风公司党组织参与合资企业重大问题决策的调研报告].

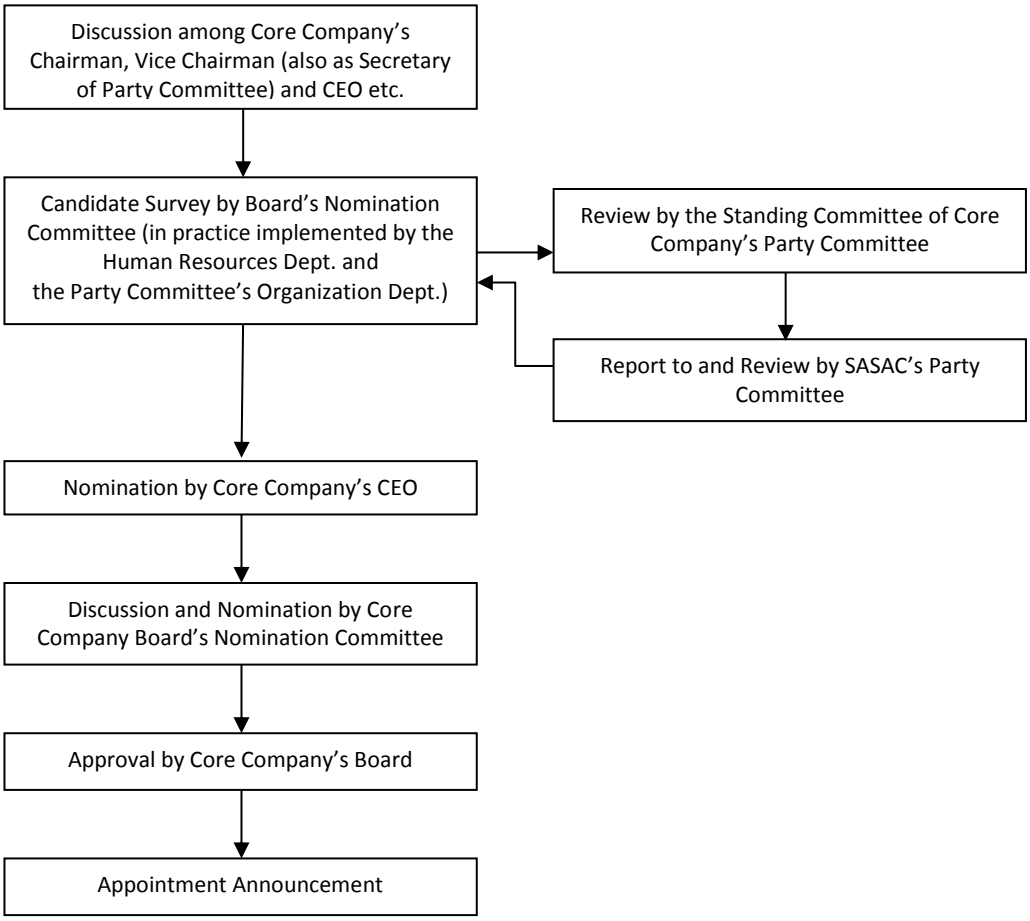
[23] Article 32.

term development plans, operation management directions, annual financial budgets, assets reorganization, corporate reform policies and rules, and appointments of important positions.[24] The party committee's appointment power is of particular importance because appointing decision-makers is a fundamental step in controlling other important matters.

[Figures 10-12] illustrate how the party committee at the core company of Baosteel Group participates in the appointment process. Baosteel Group is a large business group owned by the Chinese central government and the core company is now ranked at197th on the Fortune Global 500 list. As shown in the figures of the appointment processes, the party committee surveys and screens possible candidates before the board of directors can make a final decision. The board of directors essentially exercises its appointment power within the boundary delimited by the party committee. Moreover, the appointment power of the core company's party committee reaches down to subsidiaries in the group, including its publicly traded subsidiary, as shown in [Figures 11 and 12]. While the party committee plays such an important role in corporate decision-making, the party institution is entirely missing in the Chinese company law and only slightly mentioned (if at all) in corporate annual reports published to outside investors.

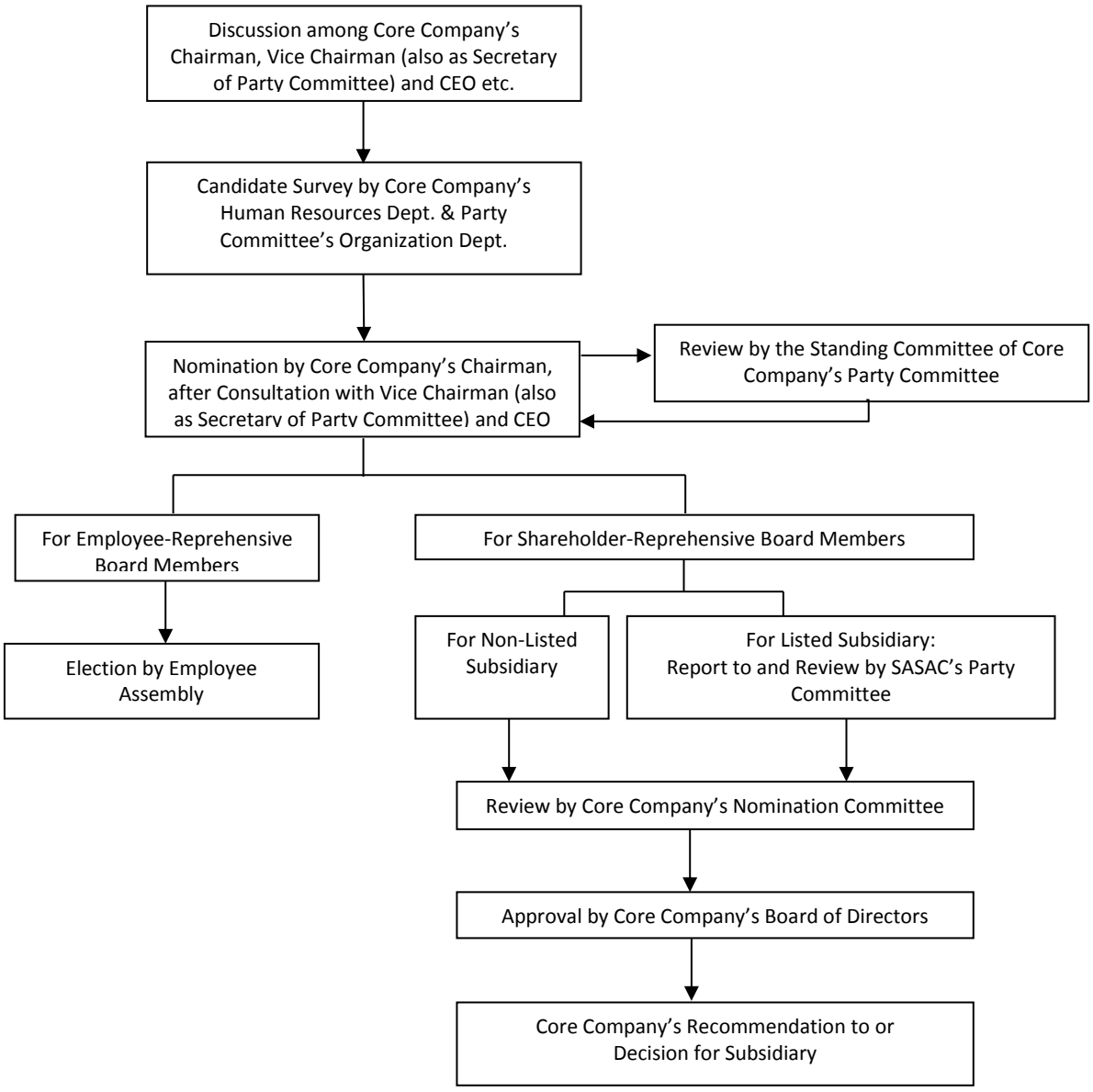
[24]中央组织部、国务院国资委党委关于加强和改进中央企业党建工作的意见（2004 年 10 月 31 日）

[Figure 10]
Appointment Process for Important Positions in the Core Company of Baosteel Group



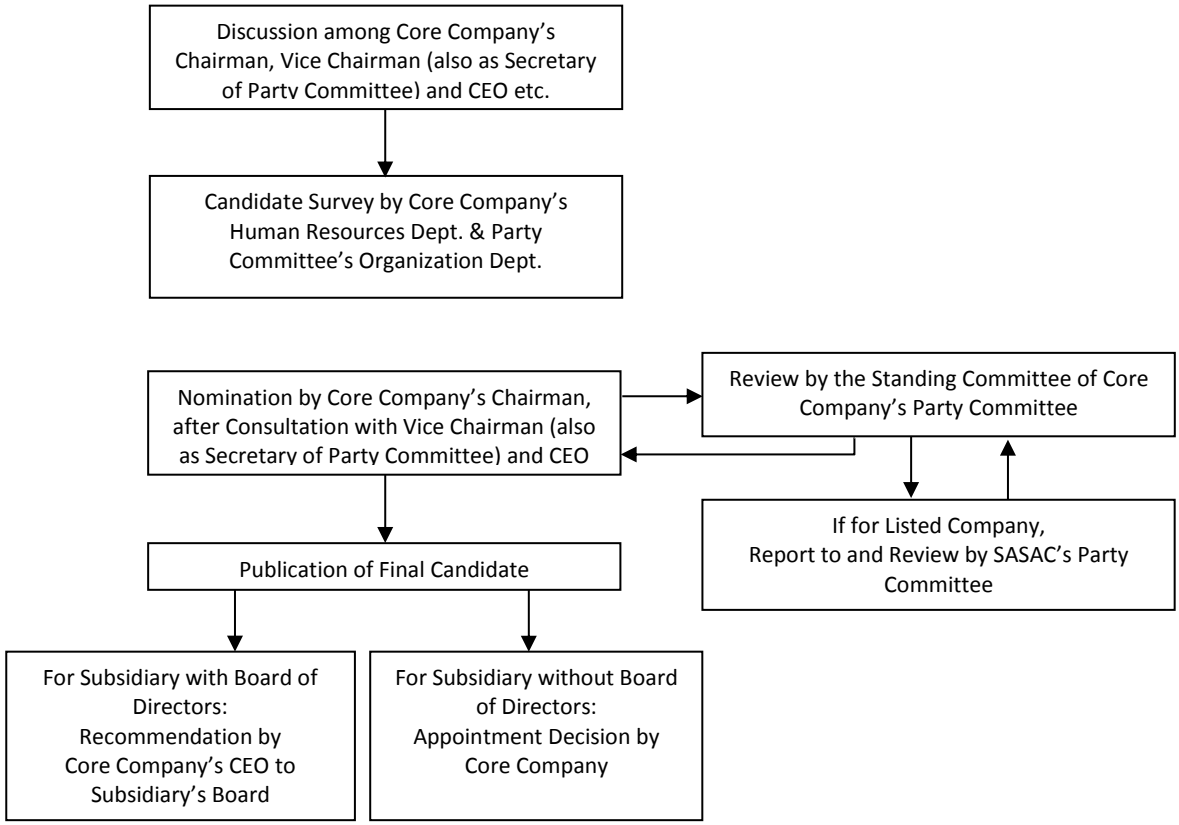
Note: This appointment process applies only to positions from vice CEOs and below. CEO and board members are appointed by a separate process controlled by the central SASAC.
Source: adapted from Baosteel Group Party Committee's Organization Department et al. (2009).

[Figure 11]
Appointment Process for Board Members in Subsidiaries of Baosteel Group



Source: adapted from Baosteel Group Party Committee's Organization Department et al. (2009).

[Figure 12]
CEO Appointment Process in Subsidiaries of Baosteel Group



Source: adapted from Baosteel Group Party Committee's Organization Department et al. (2009)

In addition to inserting party organs into the SOEs, the Party has institutionalized personnel linkages between the SOEs and several elite (if functionally obscure) political bodies. Chief among these bodies are the national and local People's Congresses, the central and local governments' symbolic legislative bodies; the People's national and local Political Consultative Conferences, a type of advisory bodies composed of representatives of different social and political groups; and the national and local Congresses of the Chinese Communist Party, the Party's general assemblies at the national and local levels. For example, based on a pool of candidates recommended by the party committees of the 120 central enterprises extent at the time, the central SASAC, the SOE supervision agency of the central government, nominated 22 managers as representatives in the 11th National People's Congress and 99 managers to be representatives in the 11th People's Political Consultative Conference, both of which run from 2008 to 2013.[25] In 2007, the Party Committee of SASAC and the party committees of the 125 central enterprises extent at the time selected 47 representatives to the 17th National Congress of the Chinese Communist Party.[26] The composition of the selected representatives was based on instructions from the Central Organization Department of the Chinese Communist Party, which specified that no more than 70% of the positions should go to top managers of the core companies, and that no less than 30% should go to middle managers of core companies and top managers of their subsidiaries.[27] As the Chinese "democracy" operates a representation system with quotas based on groups of political, social and economic importance, the allocation of political seats to the economically- prominent SOEs comes with little surprise.

[25] China's State-Owned Assets Supervision and Administration Yearbook (2008), p.81.

[26]关于做好中央企业系统（在京）十七大代表候选人推荐工作的通知, issued in 2006. Also, China's State-Owned Assets Supervision and Administration Yearbook (2008), p.93.

[27] 关于做好中央企业系统（在京）十七大代表候选人推荐工作的通知, issued 2006.

As shown in details below and Chapter 3, the Party and many other government units such as SASAC and supervisory bureaus also play a major role in the appointment and business matters in the SOEs. At one time, there may have been ideological reasons for the Party's pervasive role in SOEs. But a compelling political economy explanation for the practice is also apparent: The Party constitutes a massive interest group that maintained extensive ties to economic enterprises in the central-planning era. Indeed, in that era, there was often little separation between governmental, economic, and social organizations, and the Party was involved pervasively across all three spheres of activity. Corporatization and other economic reforms could have posed a major threat to the comprehensive integration under the party rule. Institutionalized political connections in the post-reform SOE sector can be seen as a way of maintaining the integration. The institutionalized political ties, on the one hand, help SOEs buy the support of the Party for reforms that it might have otherwise blocked and on the other hand, help the Party monitor the SOEs.

2.2 Schizophrenic Connections to SASAC

As explained in Chapter 1, China's large SOEs are organized as business groups with the core companies standing at the top of ownership hierarchy. Tracing the ownership connections upward beyond the core companies leads to the State-Owned Assets Supervision and Administration Commission (SASAC), a SOE supervision agency exercising shareholder rights on behalf of the state-owner.

China's SOEs traditionally were indistinguishable from other government units and strictly integrated into the state system. There was no discernible distinction between the state as the government and as the asset owner, which has been viewed as a root cause of inefficient management and poor corporate governance of the SOEs. Based on the SOE reform advice by

the China Economic Reform Commission and the World Bank, the Chinese central government in 1988 created the Bureau of State Assets Management, an agency organized directly under the State Council but supervised by the Ministry of Finance. The Bureau was authorized to exercise the control rights, the financial right and the right of asset disposal. However, at that time, the State Council did not seriously intend to centralize the management powers over the SOEs into one single agency. The management powers in fact were still distributed among multiple party or government organs. For the central SOEs, capital management issues were supervised by the Ministry of Finance, investment projects were managed by the National Planning Committee, ordinary business operation matters were by the National Economic and Trade Commission, labor and wage issues were by the Ministry of Labor and Social Security, top manager appointments were decided jointly by the Organization Department of CPC and the Enterprise Working Committee of CPC, and industrial production matters were supervised by related industrial ministries. There remained little coordination and lots of conflicts among these supervisory entities. The Bureau's actual functions in reality were reduced to assessing asset values, clarifying and registering which assets belonged to which enterprises, and promulgating rules concerning the previous two functions. In 1984 the Bureau was absorbed by the Ministry of Finance, essentially abolished. The old dispersed governance structure continued after the abolishment of the Bureau.

The creation of SASAC represents the state's second attempt to consolidate control rights over the SOEs. SASAC is a special agency established under the central or local governments. At present, besides the central SASAC, there are 31 SASACs at the provincial level and 331 at the lower-government levels.[28] Most of the largest 300 or so non-financial SOEs in China are

[28] Speech delivered by Shuhe Huang, Vice Commissioner of SASAC of the State Council (2011), available at http://www.sasac.gov.cn/n1180/n14200459/n14550482/n14550501/14550882.html

supervised either by the central or provincial SASACs. The major functions and responsibilities of SASAC include preserving and enhancing the value of state-owned assets, restructuring SOEs, appointing and removing top SOE executives, and drafting regulations on the management of SOE assets.[29] But despite outward appearances of consolidated control over the SOEs it formally supervises, SASAC is a work in progress, and the SOEs' legacy of diffused control rights was not overcome simply by SASAC's establishment. This is evidenced in SASAC's location in the government organizational charts. Although the central SASAC is a ministry-level agency, so are fifty-three of the most important SOEs under its supervision. The central SASAC faces potential resistance not only from the firms it supervises but also from the competing agendas pursued by other important ministries, such as the Ministry of Finance (Naughton 2008). Some of the local SASACs have a more awkward status as they have been downgraded as part of other administrative agencies.[30] As one commentator notes, "In practice, SASAC has faced an uphill struggle to establish its authority over the SOEs that it supposedly controls as a representative of the state owner" (Martin 2011).

Until recently, there was no overarching legal authority governing SASAC in its role as controlling shareholder. In 2008—tellingly, after an arduous process of interest group balancing that began in 1993—the Law of the People's Republic of China on State-Owned Assets of Enterprises (SOE Asset Law) was enacted to "safeguard[] the basic economic system of China . . . , giving full play to the leading role of the state-owned economy in the national economy."[31] While the law ostensibly authorizes SASAC comprehensive shareholder rights over the SOEs, SASAC in reality has both less and more power than those available to a typical controlling

[29] Main Functions and Responsibilities of SASAC, http://www.sasac.gov.cn/n2963340/n2963393/2965120.html
[30] Supra note 28.
[31] Zhonghua Renming Gonghe Guo Qiye Gouyou Zichan Fa [SOE Asset Law], art. 1 (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 28, 2008, effective May 1, 2009) http://www.gov.cn/jrzg/2008-10/28/content_1133922.htm (China).

shareholder under corporate law. An anatomy of SASAC's control rights below show that it is weaker because it has incomplete appointment and cash flow rights to the SOEs under its control. It is more powerful due to the vast scope of its holdings over the most important firms in the national economy and because of its super control rights, which trump standard corporate-law norms, in state-enterprise assets. Even beyond this disjuncture in its formal status and powers, SASAC is unique as the focal point in the Chinese state capitalism. SASAC in the front has legal control rights over the SOEs along the ownership linkages while in the back there are legally-invisible but practically constraining ties attached to it by other major actors in the party-state's control network. The party-state exerts control over the SOEs through a network of the invisible linkages attached behind SASAC's legal appearance.

2.2.1 Control Rights in Management

As with controlling shareholders everywhere, one of SASAC's main formal powers is the selection and compensation of top managers. But SASAC exercises this power in the shadow of party control. Various party organs held appointment power in the SOEs prior to the establishment of SASAC and retained this practice even after its establishment. "Political qualities," including party membership, are among the major criteria against which managerial performance is evaluated.[32]

As just noted, all Chinese SOEs have both party and corporate management teams. Party and corporate leadership appointments take place in a highly institutionalized sharing arrangement between the Party and SASAC. In fifty-three central enterprises, the occupants of top positions, including board chairmen, CEOs, and party secretaries, are appointed and

32. *See* Zhongyang Qiye Lingdao Banzi he Lingdao Renyuan Zonghe Kaohe Pingjie Banfa (Shixing) [Measures Concerning the Integrated Evaluation of the Top Management Teams and Managers of the Central Enterprises (Provisional)] (promulgated by the Org. Dep't Communist Party of China, Nov. 6, 2009), http://gzw.xinjiang.gov.cn/10050/10090/10012/2010/19547.htm.

evaluated by the Organization Department of the Party's Central Committee. This is a legacy of the appointment practice prior to the establishment of SASAC. Some of these positions hold ministerial rank equivalent to provincial governors and members of the State Council; others hold vice-ministerial rank. Deputy positions in these enterprises are appointed by the Party Building Bureau of SASAC (the Party's organization department within SASAC). A separate division of SASAC, the First Bureau for the Administration of Corporate Executives, assists in this appointment process. Appointments and evaluations of top executives in the remaining central enterprises are made by yet another division of SASAC, the Second Bureau for the Administration of Corporate Executives. While the appointments power formally resides with SASAC, appointments are made with input from various party organs and ministries supervising relevant business operations, and are subject to approval by the State Council.[33]

The appointment and evaluation process for top managers of the SOEs is supported in two ways: ministry/bureau recommendations and Party leadership training. The Party's Organization Department and SASAC compensate for information asymmetries about talent and suitability of individual SOE managers by obtaining input from the ministries or bureaus overseeing the industries in which SOEs operate. Moreover, SOE managers are trained in the Party school system, which serves as a think tank and midcareer training center for cadres. The Central Party School in Beijing, the most important and prestigious of these schools, offers specialized training classes for SOE managers (Shambaugh 2008). While little information is available about the content of this training, the Party school system appears to provide an excellent opportunity for Party leadership to evaluate the intelligence, skills, and commitment of those who pass through its programs.

33. *See* SASAC, Zhongguo Guoyou Zichan Jiandu Guanli Nianjian (中国国有资产监督管理年鉴) [CHINA'S STATE-OWNED ASSETS SUPERVISION AND ADMINISTRATION YEARBOOK] 99 (2004) [hereinafter SASAC Y.B. 2004].

The standard corporate mechanism for the appointment and evaluation of senior executives—the board of directors—is missing entirely from this process. Indeed, only fifty-one of the core companies of the 117 central business groups even had boards of directors at the end of 2012. Although SASAC and the Party have begun to bring boards of directors into the appointment process and to create boards for those core companies that do not yet have them, the steps taken thus far leave little doubt that the Party does not intend to relinquish appointment authority over the most important enterprises and the highest-level appointments.[34]

[Table 9] shows the leadership appointments and removals of the SOEs under the central SASAC's supervision from 2003-2009. The data include leaders in the corporate and party personnel systems. It shows that from one-third to three-quarters of the central SOEs experienced at least one appointment or removal of a leader by the central SASAC in the covered years. The central SASAC does not explain why the number of appointments systematically exceeds the number of removals. But the most likely explanations are that (1) some appointments are actually reappointments of incumbents without any corresponding removal and (2) some enterprises established a board of directors during the covered period, creating new positions for appointment.

34. In 2008, SASAC and the Organization Department of the Communist Party promulgated Guidance Opinions on Top Manager Appointments by the Board of Directors of Central Enterprises. These Opinions for the first time gave some appointment power to boards. However, the CEOs of the top fifty-three central enterprises are not covered by the Opinions. Even with respect to other enterprises, the nomination committee of the board is required to "fully consult" with the Party Committee and SASAC before nominating a CEO. The preliminary appointment must be filed with SASAC before the appointment becomes final.

[Table 9]
Appointments and Removals of Leaders of the Chinese Central Enterprises

Year	Number of Central Enterprises	Number of Central Enterprises with Appointments or Removals	Percentage of Central Enterprises with Appointments or Removals	Number of Appointments	Number of Removals
2003	196	65	33.16%	150	79
2004	178	77	43.26%	224	155
2005	169	113	66.86%	237	158
2006	159	101	63.52%	323	136
2007	155	90	58.06%	317	113
2008	148	95	64.19%	358	146
2009	129	97	75.19%	312	145

Source: SASAC, Zhongguo Guoyou Zichan Jiandu Guanli Nianjian (2005) (2006) (2007) (2008) (2009) (2010) [CHINA'S STATE-OWNED ASSETS SUPERVISION AND ADMINISTRATION YEARBOOK] (2005) (2006) (2007) (2008) (2009) (2010)
**Leaders* include members of boards of directors, CEOs, vice-CEOs, chief accountants, secretaries of the Party Committee, deputy secretaries of the Party Committee, and secretaries of the Party's Discipline Inspection Committee.

One of SASAC's leadership management strategies is rotating senior corporate and party leaders among business groups. [Table 10] shows that rotations are fairly common. Most of the corporate rotations reflected in the table are of directors or vice-CEOs and that the party rotations are for positions below secretary of the party committee. From time to time, however, the rotations were among top executives in key industries. For example, in April 2011, the central SASAC rotated CEOs of the three central petroleum enterprises, each of which is a Fortune Global 500 Company. The central SASAC made similar rotations among top executives in the energy sector in 2008 and telecom in 2007 and 2004. Such rotations obviously ignore the separate identity of the corporate groups and flout standard corporate-law concepts. But the practice is less jarring conceptually if all the national SOEs are viewed as one diversified meta-group under common (if somewhat attenuated) control of SASAC. Such rotation functions as a learning device to share management experience as well as a monitoring device to reduce concentration of authority in a single individual in firms in which institutionalized corporate-oversight organs such as the board of directors have yet to be develop. As [Table 10] shows,

leaders are also rotated across the spheres of business, government, and the Party. The inter-sphere rotations are viewed to facilitate the mutual understanding and strengthen the binding between the government/the Party and SOEs.[35] Chapter 3 will give a detailed analysis of the rotation patterns at the individual career level.

[Table 10]
Leader Rotations in the Chinese Central State-Owned Enterprises

Year	Leader Rotations				
	Between Central Enterprises	From Central Enterprises to Government or Party	From Government or Party to Central Enterprises	From Local SOEs to Central SOEs	Total Rotations
2004	27	6	13	0	46
2005	27	5	14	0	46
2006	20	3	10	1	34
2007	33	7	16	0	56
2008	NA	NA	NA	NA	50
2009	NA	NA	NA	NA	27

Source: SASAC, Zhongguo Guoyou Zichan Jiandu Guanli Nianjian (2005) (2006) (2007) (2008) (2009) (2010) [CHINA'S STATE-OWNED ASSETS SUPERVISION AND ADMINISTRATION YEARBOOK] (2005) (2006) (2007) (2008) (2009) (2010)
*Leaders include members of board of directors, CEOs, vice-CEOs, chief accountants, secretaries of the Party Committee, deputy secretaries of the Party Committee, and secretaries of the Party's Discipline Inspection Committee.

Concomitant to its appointment power, SASAC in coordination with the Party's Organization Department, the Ministry (Bureau) of Human Resources and Security, the Ministry (Bureau) of Finance and a number of other government agencies also supervises executive compensation at the SOEs. Prior to SASAC's establishment, managerial compensation was determined by the SOEs themselves, which led to a series of problems as well as major inequalities in pay across firms.[36] In 2004, SASAC introduced a system to supervise compensation. Under this system, the basic structure of managerial compensation consists of base salary, performance bonuses, and mid- to long-term incentive compensation. The standard

[35] Dang Zheng Ganbu Jiaoliu Gongzuo Guiding [Regulations on Party and Political Leadership Exchanges], promulgated 2006.

36. Based on SASAC's investigation, the major problems included lack of state supervision and mechanisms to encourage long-term performance, loose linkage between compensation and performance, and great pay inequalities across firms. *See* SASAC Y.B. 2004, at 85-86.

corporate-law organs for determining executive compensation—boards or, perhaps, boards in cooperation with shareholders—are bypassed by this process. Indeed, as discussed in Section 2.3 below, the board-approved, shareholder-disclosed compensation paid to executives of listed companies of the state-owned groups is something of a fiction—the actual compensation received by the executive is set by SASAC.

2.2.2 Control Rights in State Enterprise Assets

SASAC's central mission is to preserve and increase the value of state assets while transforming SOEs into public companies. Since its establishment, SASAC has pursued a policy of building several large enterprises in each key industry. In recent years, SASAC has consolidated smaller and weaker SOEs into larger business groups. In the process, the number of SOEs under the central SASAC's supervision has declined to 113 in 2013, from 198 in 2003. The central SASAC's goal is to bring the number to below 100. Simultaneously, as the Fortune Global 500 list attests, the central and a few local SASACs have successfully pursued the goal of building globally competitive conglomerates.

This central mission makes SASAC a gatekeeper with respect to transfers of SOE assets. With passage of the SOE Asset Law, SASAC now has solid legal backing for this role. Under the SOE Asset Law, share transfers involving SOEs require SASAC's approval, even with respect to transactions over which it does not have veto power as a shareholder under the Company Law.[37] Some Chinese courts have upheld SASAC's superior control rights under the SOE Asset Law by holding that contracts for transfer of shares entered into without SASAC's approval are unenforceable or invalid, even when they are consistent with the Company Law. SASAC has super control rights in the transfer of SOEs.

37.For example, SASAC's approval is required to transfer shares of a subsidiary of a company under its direct control. Under corporate-law principles, only the board of directors of the company directly under its control has authority to approve such a transaction.

2.2.3 Cash Flow Rights

The separation of cash flow rights from control rights is a central problem in controlling-shareholder regimes. When a shareholder's control rights exceed its rights to cash flows, the agency problem between the controller and minority shareholders is magnified; the scale of the problem grows as the wedge increases. As Ronald Gilson puts it: "Conditional on maintaining control, the less equity the controlling shareholder has, the greater the incentive to extract private benefits [at the expense of minority shareholders]; increased productivity accrues to shareholders in proportion to their equity, while private benefits of control are allocated based on governance power" (Gilson 2006:1651).

In controlling-shareholder regimes outside the SOE context, the separation of control rights from cash flow rights, and the ensuing potential to extract private benefits, arises because controllers are able to magnify equity's voting power through pyramiding and circular stock-ownership arrangements among corporations in the group. In the SOE context, regulators and politicians acting as "owners" on behalf of the state may reap private benefits of control not shared with ordinary financial investors, such as political influence, opportunities for patronage or corruption, and national prestige. These types of pecuniary and nonpecuniary private benefits of control over the SOEs are clearly available to the Chinese party-state's managerial elite, and SASAC is a major vehicle through which such control is exercised. Beyond its role as a vehicle for party-state governance of the SOE sector, the organizational incentives of SASAC as the formal "owner" of the SOEs are affected by a peculiar historical circumstance: SASAC's control rights exceed its rights to cash flows because, until recently, the state collected no dividends from wholly state-owned firms (i.e. the core companies) under SASAC.

As the SOEs historically were in a moribund condition, the state relieved all the wholly SOEs from paying dividends since 1994. The dividend distribution requirement was just

reinstated in 2007.[38] The old power structure prior the establishment of SASAC remains valid in exercising the right to collect and distribute financial returns (Naughton 2008). The financial agency (the Ministry of Finance for the central SOEs while the Bureaus of Finance for the local SOEs) collects the dividends and coordinates with SASAC regarding the use of the money. The dividend rates are set mainly based on broad-brush industrial categories rather than specific individual firm performance. At present, the dividend payouts for the central SOEs are between 5%-20% of net profits depending on their industry sector, while most local SOEs are still exempt from paying dividends.

Of the 100 billion RMB ($16.5 billion USD) dividends collected from the non-financial central SOEs in 2013, about 93.5% was ploughed back into SOEs in the form of financing for corporate restructuring, foreign investments and technology invention, according to the Ministry of Finance 2013 budget report. Thus, SASAC does not fully internalize the financial consequences of its control rights over the SOEs, and it cross subsidizes the firms under its supervision with the cash flow rights that it does hold.

These realities suggest that SASAC considers all the SOEs under its supervision as a whole when carrying out its governance responsibilities, and they may account for several outwardly puzzling aspects of governance in China. For example, the practice of rotating top managers among firms in the same industry makes a good deal of sense if maximizing shareholder wealth at individual firms is less important to the controlling shareholder than building up a number of globally competitive firms in critical industries. Another example is SASAC's heavy emphasis on corporate social responsibility (CSR) of the enterprises under its supervision (Lin 2007, 2009, 2010). CSR is a theme typically trumpeted by non-shareholder

[38] As early as 2003, some local governments in Beijing, Shanghai and Shenzhen already experimented with collecting dividends from the SOEs under their supervision. But the nationwide formal policy was introduced until 2007.

corporate constituencies or by NGOs, not by large investors. But the CSR campaign by SASAC might be a means of building support for state capitalism domestically, improving its image abroad, and justifying management of the SOEs in ways that are not explicable solely from the standpoint of profitability and efficiency of individual firms.

2.3 Managerial Compensation Obscured in the Network

As shown so far, China's large SOEs are not only embedded in a vertically-integrated ownership network in the form of a business group but also a network of pervasive connections to the Party, SASAC, and various government organs. From a network insider's perspective, such organizational relations can create information flows, enhance mutual understanding, share learning experience, and strengthen elite cohesion. But from a network outsider's perspective, they create obstacles to penetrating into the inner working of the governance system, especially as many relations are invisible to the public eye. Network insiders can easily hide information in the network and therefore obfuscate transparency of corporate governance. The practice of managerial compensation in China's SOEs provides a good example of how both the business group and the state control network complicate actual executive pay.

When approaching managerial compensation of China's SOEs, most scholars focus on the listed subsidiaries of the corporate groups primarily due to data availability. They also tend to ground their research questions from the perspective of agency theory. As agency theory is concerned with how to align the interests between top managers (agents) and shareholders (principles), the main research question revolves around the correlation between executive pay and firm performance. Chinese state-owned listed companies are found to pay less than private firms (Chen et al. 2011; Firth el al.2006, 2007; Conyon & He 2011, 2012) and to have weaker pay-performance sensitivity than private counterparts (Kato & Long 2006; Firth el a. 2007;

Conyon & He 2011). Moreover, the state-owned listed companies are more likely to link executive compensation to accounting performance and employment intensity than stock returns (Firth et al, 2006 2007; Conyon & He 2012).

All the empirical studies are based on the executive pay information disclosed in the annual reports of the state-owned listed companies. While the findings are insightful, there are limitations in understanding Chinese SOEs' actual managerial compensation practices by relying on such executive pay information disclosed in the annual reports. As shown in details below, there are simultaneously under-, over- and non-reporting problems in China's SOEs' executive compensation disclosure. These problems are directly or indirectly related to the organizational networks in which the SOEs are embedded. The business group structure and the state control network create routine personnel flows among member companies in the business group and across the SOE and government spheres. Such personnel flows generate peer effects on compensation among the business and government leaders and thus complicate in actual SOE managerial compensation.

First of all, an under-reporting problem in the executive compensation disclosure comes from an institutionalized practice called on-duty consumption. An average CEO of a Chinese listed company earns only 355,150 RMB (about 58,000 USD) as disclosed in the 2011 corporate annual reports (Conyon & He 2012). While the executive pay seems significantly lower than that in Western counterparts, the number does not include perks and benefits such as free lavish housing, education, and entertainment. In the United States, similar on-duty consumption is used and explicitly stipulated in employment contracts but accounts for only a small portion of executive compensation. In China, however, such consumption is an implicit norm and accounts

for a significant part of executive income.[39] On-duty consumption as an important component in the pay structure was historically designed to supplement the government cadres' low salaries and remains implemented throughout the government system nowadays. The personnel connections between the SOEs and government bureaus foster the identity interchangeability between SOE executives and government cadres. The identity interchangeability creates peer group effects on the pay structure and makes the SOE executive compensation method oriented toward the pay standards in the government system.

Second, the disclosure practice of China's state-owned listed companies has an over-reporting problem. Based on interviews with insiders of the SOEs, information from publicly available news reports and analysis of directors' stock option exercise behavior, Chen et al. (2011) find that the stock options granted to the directors of China's state-owned listed firms are fake, primarily designed to fool foreign investors. The SOEs executives are contractually prohibited from freely exercising granted stock options without the state-owner's specific consent.[40] The state-owner imposes such constraint because this high-powered incentive compensation is incompatible with the personnel network in which the SOEs are embedded. The identity interchangeability through the SOE-government personnel connections practically creates compensation comparability across the SOE and government leaders. Exercising stock options can skyrocket executive pays. It would cause a great pay divide between SOE executives

[39] There is no outright method to show the scale of on-duty consumption. The disclosure regulations of the Shenzhen and Shanghai stock exchanges stipulate that on-duty consumption by executives is to be accounted for as an "administrative expense, which can offer a glimpse of the hidden income. Using "administrative expenses" disclosed in annual reports as an indirect indicate for on-duty consumption, a study finds that 10 of the top 100 public companies in the year of 2010 had the on-duty expenses exceeded the revenues. Another study finds that based on 1,320 listed companies examined between 2002 and 2009, on-duty consumption exceeded average executive compensation by two to 50 times, and has been growing over the years. One study finds that on-duty consumption in SOEs has a significant negative correlation with corporate earnings. (Knowledge@Wharton 2012)

[40] "These stock options are all fake. Besides the stock option contract, we sign another contract which commits (executives) to 'not exercise these rights with liberty'. – said by an anonymous PetroChina executive quoted by the Caijing magazine, June 23, 2008."

and other cadres staying in the government system and as a result would potentially breed a sense of resentment and unfairness.

Third, the personnel connections within the business group combined with a regulatory lacuna allow non-disclosure of executive compensation of many top managers of China's state-owned listed companies. Under the Chinese securities regulations, the listed company is not required to disclose the manager's compensation if the manager receives no pay from the listed company. [Table 11] below shows a significant number of top managers in China's listed companies received no compensation from the listed companies. In the past years, about 24% of the top managers of all the listed companies received no pay from the listed companies. This phenomenon is even more prominent among the listed companies affiliated with the national groups under the central SASAC's supervision. On average, about 30% of the top managers of listed companies affiliated with the national groups received no compensation from the listed companies. [Table 12] breaks down the types of managers who received no compensation from the listed companies. A majority of the non-pay managers were board members. [Table 13] shows in more detail about the number of no-pay chairmen of the listed companies. Over the past several years, about 35% of the chairmen received no compensation. The figure is more astounding for the population of the listed companies affiliated with the national groups under the central SASAC's control. On average, about 64% of the chairmen received no compensation from the listed companies. Such no-pay phenomenon is mainly due to many top managers of the listed companies are simultaneously executives of the core companies or other member companies in the business groups and compensated by these non-publicly traded affiliated entities subject to no disclosure obligations. Managerial compensation thus can be shrouded in the ownership and personnel network of the business group.

[Table 11]
No-Pay Top Managers of Listed Companies

	All Listed Companies			Listed Companies Affiliated with National Groups under central SASAC		
Year	Total Managers	No-Pay Managers	No-Pay Managers (%)	Total Managers	No-Pay Managers	No-Pay Managers (%)
2005	24,722	6,077	24.58%	3,555	1,117	31.42%
2006	25,981	6,360	24.48%	3,727	1,139	30.56%
2007	28,253	6,689	23.68%	3,959	1,170	29.55%
2008	30,063	7,168	23.84%	4,116	1,208	29.35%
2009	32,531	7,585	23.32%	4,420	1,270	28.73%
2010	38,466	8,359	21.73%	4,387	1,306	29.77%

Data Source: collected by author from CSMAR database. CSMAR is one of the most commonly used databases providing comprehensive financial and corporate governance information of China's listed companies.

[Table 12]
No-Pay Top Managers of All Listed Companies, by Position Type

Year	Total No-Pay Managers	No-Pay Directors	No-Pay Independent Directors	No-Pay Chairmen	No-Pay CEOs	Other No-Pay Managers
2005	6,077	3,742	195	484	57	2,278
2006	6,360	3,941	238	510	63	2,356
2007	6,689	4,147	286	550	63	2,479
2008	7,168	4,508	352	600	60	2,600
2009	7,585	4,772	414	619	73	2,740
2010	8,359	5,271	397	671	83	3,005

Data Source: collected by author from CSMAR database.

[Table 13]
No-Pay Chairmen of Listed Companies

	All Listed Companies			Listed Companies Affiliated with National Groups under central SASAC		
Year	Total Chairmen	No-Pay Chairmen	No-Pay Chairmen (%)	Total Chairmen	No-Pay Chairmen	No Pay Chairmen (%)
2005	1,372	484	35.28%	187	123	65.78%
2006	1,448	510	35.22%	194	121	62.37%
2007	1,570	550	35.03%	203	130	64.04%
2008	1,686	600	35.59%	211	136	64.45%
2009	1,792	619	34.54%	219	136	62.10%
2010	2,170	671	30.92%	228	143	62.72%

Data Source: collected by author from CSMAR database.

Finally, executive compensation disclosed in the state-owned listed company's annual reports can be seriously misleading as SASAC can exert control over the listed company's executive compensation through the ownership and personnel networks within the business

group. Whenever an executive takes positions both in the core company and the listed company, the executive's pay is directly determined by SASAC rather than the board of the listed company.

In 2004, SASAC introduced a system to supervise compensation at the SOEs. Under the system, the basic structure of managerial compensation consists of base salary, performance bonuses, and mid- to long-term incentive compensation. It employs complex personnel-evaluation systems to determine managerial compensation. Top managers enter into binding annual performance agreements with SASAC that specify evaluation criteria and benchmarks and applicable rewards and punishments. Annual performance scores are transformed into letter grades from A to E, and bonuses are determined according to these grades. Moreover, since maintaining income equality is a government policy, SASAC imposes executive-to-worker pay ratios. For example, according to the central SASAC's most recent rule, executive compensation including base salary and performance bonus should be no more than 20 times of an average central SOE worker's pay.[41] The equality policy may partially explain a common empirical finding that Chinese SOEs have weaker sensitivity between performance and executive compensation than their private counterparts.

[Table 14]
Executive Compensation of Central SOEs under SASAC's Supervision

Year	Average Compensation (1,000 RMB)
2004	350
2005	430
2006	470
2007	550
2008	NA
2009	600
2010	650-700
2011	650-700

Note: About one-third was base pay and two-thirds performance based. Data Sources: Speech of Li Rongong, SASAC Chairman, at Peking University Business School, PEOPLE.COM.CN, (Jan. 10, 2010, 8:22 AM), politics.people.com.cn/GB/1027/10736395.html; Interview of SASAC Official, SASAC's Response to Doubt on Barriers to Redistribution Reform, Jinghua News, Jan 25, 2013, available at http://epaper.jinghua.cn/html/2013-01/25/content_1965158.htm.

[41] Opinions on Further Regulating Compensation of the Top Managers of the Central Enterprises, promulgated in September 2009; other local SASACs released similar opinions.

The average executive compensation of the core companies under the central SASAC's supervision is summarized in [Table 14]. At first glance, the pay information released by SASAC seems to demystify executive compensation managed by the state-owner. Digging deeper, it raises more puzzles about the actual compensation practices of China's SOEs. While comprehensive evidence is hard to come by, some case evidence suggests executive compensation disclosed in the state-owned listed companies' annual reports can be deceiving or conflicting. According to the central SASAC, the highest-paid executive in 2007 was the chairman (Mr. Jianzhou Wang) of the core company as well as the listed company of China Mobile Group, who earned 1.3 million RMB (about $182,000 USD) including salary and bonus. But the annual report of the listed company of China Mobile Group shows that the chairman's pay (salary and bonus) in 2007 was 2.282 million HKS (2.145 million RMB) much more than the figure disclosed by the central SASAC. Using the SASAC's number (i.e. 1.3 million RMB) as the maximum benchmark, the 2007 annual reports of the listed companies of UNICOM Group and China Telecom Group, the other two telecom groups under the central SASAC's supervision, also disclosed way-over-the-benchmark compensation for the executives who assumed positions both in the core and the listed companies.[42] In other words, the SASAC's executive compensation information is inconsistent with the information released in the listed companies' annual reports. The details of other similar cases suggest the board-approved compensation disclosed in the state-owned listed companies' annual reports is something of a fiction because the actual compensation is determined by SASAC rather than the listed company

[42] In 2007, the Chairman and CEO of the listed subsidiary and the Chairman of the core company of China Unicom Group was paid by the amount of 4.713 million RMB, according to the listed company's annual report. Along with the Chairman, other 7 top executives of the listed company, who were also top managers of the core company, also received compensation way above the number disclosed by SASAC. Similarly, in 2007, the Chairman of the listed subsidiary and the CEO of the core company of China Telecom Group should receive 1.98 million RMB, according to the annual report; and other 6 top executives of the listed company, who were also executives of the core company, also got compensation in an amount much higher than SASAC's number.

itself.[43] The state-owner uses the ownership and personnel networks in which the listed companies are embedded to exert covert control over executive compensation down at the level of listed subsidiaries. Thus, focusing on the state-owned listed companies alone without probing into their organizational networks is unlikely to observe the actual managerial compensation practices of China's SOEs.

[43] Two prominent cases provide vivid details of the actual managerial compensation practices. One is about the executive compensation of CNOOC Group, one of the largest state-owned oil groups in China. The chairman (Mr. Chengyu Fu) of the listed company and the core company of CNOOC Group, one of the largest state-owned oil groups in China, would receive 6.692 million RMB (salary and bonus) according to the listed company's 2007 annual report, far exceeding the maximum figure (1.3 million RMB) released by SASAC. According to the chairman himself and the formal statement by the spokesperson of the listed company, at the time of listing shares on the Hong Kong Stock Exchange and New York Stock Exchanges in 2001, the executives of CNOOC, Inc., the major subsidiary of the CNOOC Group, reached an internal agreement whereby they would "donate" the compensation approved by the broad to the core company of the group. Thus, the compensation approved and reported in compliance with corporate and securities law norms is not actually received by the executives. (Xinhua 2009)
The other case is about the compensation of Huayuan Group, a local state-owned real estate group supervised by Beijing SASAC. According to the annual reports of the listed subsidiary of Huayuan Group, the chairman (Mr. Ren) of the listed company as well as the core company of the Group, received more than 7 million RMB. The chairman was ranked among the highest-paid executives in China. The chairman publicly explained in details how his compensation was actually determined: "The shareholder meeting of Huayan Property approved 7 million as my compensation, but SASAC did not agree. Every year, SASAC only gave me about 0.6 million. Last year (2010), my bonus was 50,000 and the total pay was 740,000…In SASAC's general meeting at the beginning of every year, SASAC evaluates prior year performance and signs contracts with top managers regarding next year performance targets. In the meeting, SASAC gives to each manager an envelope in which contains a slip stating the manager's pay. Each manager cannot see others' pay, in order to avoid conflicts among the corporate leaders. This evaluation slip is the "divine order" that really determines the pay." (Ren 2010)

CHAPTER 3

THE ELITE RIDING AND LINKING THE CHAMPIONS

3.1 Introduction

When approaching China's SOEs, scholars have typically measured their governance attributes against the international standards of corporate governance and have generally come to a conclusion that the governance institutions are lacking or dysfunctional in China. This typical approach tends to focus on the function of things (i.e. rules and structures) and overlook the character of humans. A philosophy underlying this approach is to seek corporate governance by the rule of law in lieu of the rule of man. It promises a functional legal regime of corporate governance can minimize arbitrariness exercised by human agents. The flipside of this underlying philosophy however implies that the personal attributes of corporate leaders can play a significant role in affecting the quality of corporate governance especially when legal institutions are weak, such as the case of China. As a result, simply focusing on rules or structures without investigating leadership is an insufficient approach to grasping the full picture of the governance of China's SOEs.

The importance of leadership attributes in SOE governance is further complicated by the political institutions in China. The Chinese state-owner is not an ordinary controlling shareholder. The Chinese Communist Party is the real hand in the glove of state ownership in China. As the single-ruling party, it controls all the important institutions in politics, business, media, academia and every sphere of public life in China. The chief control mechanism is the Party's sophisticated but opaque personnel management over key positions in the important institutions including SOEs (Burns 1994; Chan 2004). As one commentator notes, "[t]he Party's

control over personnel was at the heart of its ability to overhaul state companies, without losing leverage over them at the same time" (McGregor 2010:69). The Party's management over executive careers directly shapes managerial incentives and in turn influences corporate behavior of China's SOEs.

Recent studies have insightfully suggested that the Party's executive career management is a fundamental explanation for why many practices diverge from the principles of corporate law and securities regulation. For example, scholars have found that in addition to monetary executive compensation, political promotion acts as another important incentive mechanism to address the agency problem of China's state-owned companies (Cao et al. 2011). Moreover, empirical evidence shows that stock options granted to the executives of China's state-owned companies are forged simply to fool foreign investors because such compensation scheme is incompatible with the indigenous executive career management in China (Chen et al. 2011). The institutionalized personnel rotations between China's SOEs and other government units restrict the exercise of stock options which can drastically enlarge the pay gap between the SOEs and the civil servant system. Relatedly, Pistor (2012) also argues that in China's financial industry the Party's tight control over financial cadre's careers appears to be the dominant governance mechanism over ownership ties and legal rules.

While scholarship to date has recognized the Party's control over executive careers plays a significant role in shaping the governance of China's SOEs, the personnel management logics of the visible hand remain obscure to outsiders (Walder 2011; Fligstein & Zhang 2009). A fundamental question regarding the Party's executive management is who the top managers really are. From a relational perspective, do the top managers' career paths reflect the organizational connections between SOEs themselves and between SOEs and other government

units? The personnel movements across SOEs and other types of government units may reflect a dimension of the flows of information and human resources in the network. Moreover, what kinds of attributes are advantageous and sought after in the executive labor market of China's SOEs? How cohesive is the elite at the highest echelon of China's largest companies? How has the executive recruitment evolved over time? Have corporate governance reforms such as the introduction of the board of directors changed the executive composition? From a perspective of comparative corporate governance, how do the Chinese executives differ from their counterparts in other countries? Is the Chinese business elite composition converging toward that of the shareholder-oriented model or stakeholder-oriented model?

To answer these questions, it requires an analysis of the executive backgrounds and career pathways. This chapter conducts a systematic investigation of the CEO biographies of China's large industrial non-financial SOEs between 2001 and 2010. The career pathways of the financial SOEs will be examined in Chapter 4 because financial and non-financial SOEs are governed by different regulatory regimes in China, which may cause different patterns. The focus on CEOs considers that the managerial culture of Chinese companies is highly hierarchical and paternalist with decision-making power concentrated in the highest echelon of the corporate hierarchy (Zhu et al. 2008, Kong 2006, Redding & Whitt 2007, Whitt 2010). More importantly, many Chinese large SOEs have not yet established the board of directors and the management power remains concentrated in the top leader ("*yibashou*") of the corporate entity. The period of investigation (2001-2010) is set to evaluate the dynamics in executive composition under recent institutional reforms.

Over the past decade, the Chinese government has introduced a variety of rules and guidelines which are declared to professionalize and marketize the executive recruitment. The

executive reform schemes provide a roadmap to start with for identifying potential changes in the executive attributes including educational credentials, political qualities and career experiences. In addition to using the regulatory schemes as the basic analytical framework, this chapter draws upon three sources of knowledge to analyze the empirical findings on the educational, political and career attributes. The first source of information comes from China's political and business organization history, which is aimed to provide a contextualized interpretation of the findings. Because climbing to the top echelon of the corporate hierarchy usually takes decades, the contemporary elite composition is largely a consequence of institutional changes accumulated in the past. The second source of knowledge derives from sociological theories which have been frequently used to explain career patterns and achievements. This chapter particularly applies sociologist Ronald Burt's idea of "brokerage and closure" in network theory to explain the comparative advantages of certain executive career pathways and the implications for Chinese corporate governance and national economy (Burt 2005). The third source of knowledge draws from executive career studies in the literature of comparative corporate governance. The reference to comparative studies shows how the Chinese executives differ from the executives of other corporate governance regimes. The comparison helps to solve the puzzle of how China fits in the taxonomy of comparative corporate capitalism.

Under this analytical framework, this chapter shows that China's executive composition over the past decade presents some stability and change under the institutional reforms. And the stability and change have mixed signals for corporate governance development. On the whole, the executive recruitment is oriented toward politically-bounded and firm-specific-knowledge professionalism and indicates a potential trend of bottom-up and competition-pressure-driven marketization. It is a system that strongly favors insiders over outsiders and presents a high

degree of closure and cohesion. While high elite cohesion may be helpful to national policy implementation, it poses challenges to corporate governance improvement due to an increased tendency of groupthink and perpetuation of old practices which usually undermine implementation of governance reforms envisioned in the corporate law. Moreover, the comparative analysis of the business elite shows that China looks similar to countries of the stakeholder-oriented model and obviously different from the shareholder-oriented model. The apparent similarities in the elite composition among China and countries of the stakeholder-oriented model are probably formed by different country-specific underlying causes, however.

This chapter proceeds as follows. Section 3.2 discusses the executive recruitment reform rules over the past decade and the implied changes in the executive attributes. Section 3.3 traces how the executives may have come to power by constructing six types of career pathways based on the organizational structure and relational distance. This chapter hypothesizes the potential development patterns of each career pathway under the institutional reforms and discusses the corporate governance and individual career attainment implications of each career pathway. Section 3.4 empirically examines the evolution of executive attributes under the formal institutional reforms. It draws upon the specific institutional setting, social network theory and comparative corporate governance literature to analyze the empirical findings. Section 3.5 concludes with the legal implications for international regulators as well as the challenges of executive recruitment and corporate governance in China.

3.2 Institutional Reforms and Executive Recruitment

As discussed in Chapter 2, SASAC is legally tasked with a mission to consolidate the shareholder control rights that used to be dispersed among various government agencies, but in practice SASAC's controlling shareholder status is often overshadowed by the persistent old

power structure. Its appointment right is eclipsed by a deep-rooted institutional practice in China – that is, the Organization Department of the Chinese Communist Party controls the human resources management of all the important organizations including SOEs. As a result, the executive management regulations and personnel announcements are often jointly released by SASAC and the Party's Organization Department.

Since 2003, SASAC in cooperation with the Party's Organization Department have introduced plenty rules and guidelines stated to improve the quality of the SOE executive teams. The executive reform policies, in a nut shell, are oriented in the direction of professionalizing the executive teams and opening the executive labor market.[44] As the executive recruitment reforms proceed, the composition of the business elite may change. This section discusses how professionalization and marketization may cause possible changes in three dimensions: political attributes, educational backgrounds, and career pathways. Due to the complexity of career pathways, Section 3.3 will have a more in-depth discussion on the topic.

Professionalization. State ownership often raises the concern that politics would override professionalism. Seniority, personal connections ("*guanxi*") and political loyalty are important factors in job chances and promotion opportunities in China, especially for state-affiliated organizations including SOEs (Walder 1995, Bian 1999). How would these factors change under the professionalization reform? In which dimension would professionalization take place?

SASAC's executive professionalization rules suggest that professionalization will occur in a politically-bounded fashion because political allegiance remains a paramount quality in selecting top managers of China's SOEs. Political loyalty to the Chinese Communist Party as a

[44] Rather than reviewing in detail each regulatory scheme on executive recruitment, this chapter only gives a summary of key points in the relevant rules. Important regulations include, for example, Provisional Rules on Corporate Leaders of Central SOEs (2009), Provisional Measures on Comprehensive Evaluation of Corporate Leadership Teams and Leaders of Central SOEs (2009), Guidance on Public Recruitments for Senior Managers of Central SOEs (2004). Local SASACs have similar rules as well.

primary requirement suggests the Party has no intention to relinquish control over the largest economic organizations in China. Professionalism is less likely to touch on areas where sensitive political reforms may be required or subsequently triggered. Permissible reforms are expected to occur in less politically-sensitive areas such as age, education, specialization, work experience and moral integrity, as envisioned in SASAC's reform guidance.

Part of the professionalization scheme is to bring young managers into and retire old managers from the leadership teams.[45] Young managers are desirable because they may be more active, innovative and less influenced by old traditions. The professionalization reform also sets educational requirements. As academic credentials are an approximate indicator of intellectual ability, SASAC requires executives to have a minimum of a bachelor's degree.[46] Moreover, while Chinese elites traditionally are trained in engineering (Li 2001), non-engineering-trained executives are expected to be on the rise as the division of labor becomes complex in large business organizations. In terms of career experience, business-related work experience should become preferred over political career experience. In the old days, China's SOEs were managed in a way exactly like other government units, which was incompatible with modern business management. To take up this concern, SASAC requires executives to have at least 10 years of work experience in business organizations.[47] Besides the general requirements of age, education and work experience, moral integrity is a specific quality that needs significant improvement. Because China's SOEs have been plagued by corruption problems, the executive reform policies

[45] In December 2004, the central SASAC issued a regulatory order to the top 53 central SOEs regarding the mandatory retirement age of the top managers. According to the order, the ministerial-rank managers were strictly required to retire when reaching the age of 65 and the vice-ministerial-rank managers when reaching the age of 60. Local SASACs made even more aggressive requirements. For example, according to the Provisional Rules on Corporate Leaders of SOEs under Heifei City SASAC, the chief-position executives such as the board chairman and CEO should not exceed the age of 50 and the vice-position executives such as vice-CEO no more than 45 years old. The reappointed chief-position executives should not exceed the age of 55 and the reappointed vice-position executives no more than 52.

[46] Article 5, Provisional Rules on Corporate Leaders of Central SOEs (2009).

[47] Article 5, Provisional Rules on Corporate Leaders of Central SOEs (2009).

repetitively emphasize executives should have rectitude, law-biding nature and good public image. [48]

Marketization. The SOE executive head-hunting process, from opening to closing, used to take place in the complete darkness. The job information and opportunities were available only to people inside the system. The closure suggests a great likelihood of perpetuation of old habits and lack of access to new management skills. To address this problem, since 2003 the central and local SASACs with the Party's endorsement have openly solicited job applications for hundreds of executive positions including CEOs, vice CEOs, chief accountants (equivalent to CFOs) of the core companies under their supervision. Those who are interested in the executive openings may submit their applications and go through paper-based qualification reviews, standardized written examinations and face-to-face interviews. [Table 14] below shows the marketization recruitment in the past few years. Such executive head-hunting is targeting not only China's domestic labor market but also overseas talent. The political, educational and work experience requirements discussed above are allowed to be relaxed for executives recruited from overseas through this process. [49] In 2010, thirty-one senior managers of the central SOEs were successfully recruited through this process, out of 1,410 applicants worldwide.[50] The new recruitment strategy is praised by the Chinese government as a process of "openness, fairness, competitiveness, and meritocracy."[51]

[48] Articles 1, Provisional Rules on Corporate Leaders of Central SOEs (2009); Provisional Measures on Comprehensive Evaluation of Corporate Leadership Teams and Leaders of Central SOEs (2009); Regulations on Honest and Ethical Business Practice Behavior of SOE Corporate Leaders (2009).
[49] Articles 6, Provisional Rules on Corporate Leaders of Central SOEs (2009).
[50] Press Release, the First Bureau of Corporate Leader Management of SASAC, April 1, 2011.
[51] Press releases of recruitment decisions by SASAC, May 10, 2005, Aug 28, 2006, and May 22, 2007.

[Table 15]
Marketization of Recruitment Process

Year	Number of Position Openings	Number of Applicants	Number of Applicants Qualified to Take the Written Exam (STAGE 1)	Number of Applicants Qualified for Interviews (STAGE 2)
2003	7	463	135	N/A
2004	23	937	408	148
2005	25	1,207	412	159
2006	26	1,775	499	175

Source: raw data collected from SASAC Yearbooks 2004, 2005, 2006, 2007; complied by author.

Hypothetically, the marketization of the recruitment process suggests that political affiliation with the Chinese Communist Party may become a less important factor for executives recruited through this process because the value of professional experiences accumulated outside the state system may compensate for lack of political affiliation. In other words, it may open up opportunities for outsiders -- professionals who built up their careers in private or foreign companies -- to parachute directly onto the top of the SOE system. This public recruitment process also suggests a potential increase in the number of executives who have foreign study experience.

3.3 A Typology of Executive Career Pathways

Tracing executive career pathways is a useful method to investigate how the SOEs are connected with one another and with other government units through personnel relations, how the executives have come to power, on what aspects of career experience have changed under the professionalization and marketization reforms, and how the executive career backgrounds may influence corporate performance. This chapter constructs six types of career pathways based on the prevailing organizational structures of China's SOEs and the organizational distance between the SOE of concern and the organizations that the executive has ever worked for prior to the CEO appointment. The distance is defined by whether the prior organization is related to the concerned SOE in terms of supervisory authority in the government system and whether the prior

organization is an institution outside the state system (e.g. private or foreign company). Organizations that fall outside the supervisory line or the state system are considered more distant from the SOE at issue. This typology allows an evaluation of the degree of personnel integration between SOEs and other government units as well as the degree of openness of the executive labor market. Based on this typology, this chapter proposes features of each career pathway in securing the CEO position and the implications for corporate governance. Moreover, rather than simply focusing on how the CEOs have come to power, this chapter considers where they would possibly end up right after the executive position. Tracking the post-CEO status helps better understand managerial incentives and get a more complete picture of the degree of the SOE personnel integration with other government units.

3.3.1 Pathways to CEO

The Single-Group Track. As discussed in Chapter 1, China's large non-financial SOEs are typically organized as corporate groups registered with the state. A corporate group is legally required to be comprised of a parent company and at least five controlled subsidiaries. When an executive spent his or her whole career within one corporate group before the CEO appointment of that group, the executive's career follows a single-group track.

The single-group track is featured with climbing the corporate ladder from the bottom to the top. If this track is a mainstream route, it suggests a group-based seniority system is in operation in selecting the top managers of China's SOEs. Social network theory suggests executives coming to the top through the single-group pathway possess a high volume of firm-specific knowledge and insider network resources. When firm-specific knowledge is valued and when insider social connections are important, managers following the single-group track have great advantages in reaching the CEO position. From a corporate governance perspective, the

single-group track assures some professionalism due to CEO's possession of rich firm-specific knowledge. However, it also presents an increased risk of excessive power concentration especially given that the board of directors as an internal monitoring mechanism is usually absent or dysfunctional and the external governance institutions are weak in China.

The Multi-Group Track. This career pathway refers to a route in which the executive has work experience in other state-owned business groups prior to the CEO appointment. At first brush, the SOE executives following the multi-group track look similar to those changing jobs across employers in other executive labor markets. But unlike other labor markets normally governed by the invisible hand, China's SOE executive market is centrally managed by the party-state. The job movements across organizations are not as free as in other labor markets. Leaving aside personal reasons for job change across organizations, an important institutional reason for forming the multi-group track is the party-state's personnel rotation management.

Personnel rotation is a legally institutionalized system in managing civil servants in the Chinese government units and the system practically spills over into the SOEs as the boundary between the government units and SOEs is porous.[52] The party-state frequently rotates top managers across business groups of the same industry. For example, in April 2011, the state-owner rotated the CEOs of the three central petroleum SOEs in China, each of which is a Fortune Global 500 company. In the eye of the party-state, executive rotations are to perform two institutional functions. First, the executive rotations can reduce concentration of authority in a business group where institutionalized corporate oversight organs such as the board of directors have yet to be fully developed. Second, personnel rotations facilitate management skills sharing among SOEs (Pistor 2012). Personnel rotations allow executives who gained useful skills in one

[52] According to the Provisional Measures on Rotations of Civil Servants, enacted in 1996 and still effective, a civil servant who has served a leadership position for five or more years should rotate. According to the regulation, personnel rotation is to facilitate operation efficiency and prevent corruption.

business group to practically share such experience with another group. For instance, it is said that one of the reasons that Mr. Chengyu Fu was rotated from CNOOC to Sinopec in the recent CEO rotations among China's three petroleum giants is Mr. Fu's rich overseas business experience learned in CNOOC can help Sinopec's frustration in overseas expansion.

The Supervisory-Bureau Track. A SOE executive comes to power through the supervisory-bureau pathway when the executive develops his or her career mainly in the SOE's supervisory bureau(s). China's large SOEs were carved out of industry-based government ministries or bureaus in the corporatization process, which transformed governmental organs into joint stock companies. The corporatized SOEs remain supervised by the government ministries (bureaus) in terms of industrial matters. Because of the historical integration in organizational structures and the continuing supervisory relationships in business, the personnel exchanges between the SOEs and their supervisory bureaus are quite frequent. Government officials through the supervisory relations can gain firm-specific knowledge and build social connections with employees in the supervised SOEs. In addition, supervisory government officials tend to have industry-wide information and social connections. The social and informational capital can increase the usefulness of the supervisory-bureau track in securing the executive positions.

Anecdotal evidence indicates that many government officials take top echelon positions of the SOEs as a good place in preparation for retirement. Transferring to the SOEs is economically attractive because the large SOEs usually offer better monetary compensation than other government units. It is especially practicable for senior officials in the supervisory bureaus to adopt this retirement strategy given that they have accumulated relevant social and knowledge capital in hand. Due to the late-stage nature of retirement in life course, executives coming from the supervisory-bureau pathway are expected to be senior in age. This retirement pattern, in fact,

is not unique to China. In Japan, there is an institutionalized practice known as *amakudari*, where senior bureaucrats retire to join private companies or SOEs linked with or under the jurisdiction of their ministries or agencies when they reach mandatory retirement age, usually between 50 and 60 (Schaede 1995, Colignon & Usui 2003). Such personnel practices in Japan have often been criticized as corrupt and obstructive to regulatory reforms (Carlile & Tilton 1998, Norville 1998). The Japanese implication for China's SOEs seems to be that the supervisory-bureau pathway should be restricted in terms of executive professionalization and corporate governance reform.

The Unrelated-Government-Units Track. An executive follows the unrelated-government-units track when the executive's career mainly develops in government-affiliated organs other than for-profit SOEs and supervisory bureaus prior to the CEO appointment. Such government units are relatively irrelevant to the focused SOE in terms of the type of organizational identity or the nature of business matters. For example, Mr. Biting Chen first worked up his way in the Party system to the Party Secretary of the Youth League Committee of Anhui Province, then a mayor of a city in Jiangsu Province, and then promoted to the chief secretary and later the vice governor of Jiangsu Province prior to his appointment as the CEO of Shenhua Group, one of the largest energy SOEs in China and also a Fortune Global 500 company. Executives with this career pathway tend to possess more political operation skills than firm-specific or industry-specific knowledge. SOEs with such politics-tainted executives may have worse performance compared to those whose executives have more firm-specific or industry-wide knowledge. If the unrelated-government-units track is the prevailing career pathway, it suggests the management logic of China's SOEs is oriented more toward political

than business purposes. Under the professionalization reform, the unrelated-government-units track should be on the decline.

The Multi-Sphere Track. A SOE executive comes to power through the multi-sphere track when an executive's career spans multiple types of organizations such as unaffiliated SOEs, supervisory bureaus, and other unrelated government units. For example, Mr. Shulin Su first worked his way from an entry-level technician of a subsidiary up to the vice CEO position in the core company of Sinopec Group (a giant petroleum SOE) and then transferred to the Party Standing Committee of Liaoning Province prior his appointment as the CEO of China National Petroleum Corporation, one of the largest oil companies in China. This type of career pathway essentially is a combination of the previous four types. Compared to the single-group executives, the multi-sphere executives are more likely to have system-wide knowledge and diverse personal connections, which can be an advantage in career attainment. The prevalence of the multi-sphere track would suggest high personnel integration between the SOEs themselves and with other government units. This phenomenon may be detrimental to corporate governance because the SOEs would be at a higher risk of being managed in a way similar to other government units. Nevertheless, the multi-sphere track may create greater elite cohesion through shared career experiences among the Chinese political and business leaders, which can facilitate economic coordination and policy implementation at the national level.

The System-Outsider Track. All the career pathways discussed so far meander strictly within the boundaries of the state system. Executives travelling on these pathways are system-insiders, savvy with the operation of the state system. In contrast, system outsiders accumulate their career experiences in organizations unaffiliated with the state such as private or foreign companies.

Unlike system insiders embedded in a closed network, system outsiders have brokerage ties of connectivity outside the state system that provide access to new ideas and resources (Burt 2005). Executives coming from the system-outsider path are institutional brokers importing new management knowledge into the SOEs which tend to be trapped in the outdated mentality. The participation of system-outsiders into the SOE system may present a good sign of corporate governance improvement.

While system-outsiders can use their brokerage advantages to break into the SOE system and win the top management positions, it is uncertain how likely the brokerage advantages can overcome their "liability of foreignness" – the competitive disadvantages of foreigners when entering into a local system. China's SOEs have a strict hierarchy of ranks in employee administration which corresponds to the government's civil service administration. It is a persistent tradition albeit several attempts to abolish in the past. A system-outsider's parachuting onto an executive post would disrupt internal promotion expectations based on the administrative ranks. It would cause a legitimacy problem when diverging from the institutionalized expectations. Moreover, system-outsiders often lack local personal connections such as *guanxi* to gain access to job information and opportunities of the state-affiliated organizations. As a result, system-outsiders may need to build up outstanding external reputation in professionalism in order to overcome their liability of foreignness.

SASAC's marketization reform of the SOE executive labor market is expected to recruit more executives from the system-outsider path, particularly in industries where competition depends on innovation and efficiency. Competition pressures may increase the likelihood of breaking conformity with the old recruitment practices and adopting new strategies (Oliver 1992). But due to the suspicion of outsiders, the system-outsider track is less likely to occur in

industries of critical national security. Given competition pressures and security concerns, the Chinese SOEs that are likely to embrace system-outsiders tend to be in industries relatively open to the private sector such as steel, automobile manufacturing and light industries.

3.3.2 Post-CEO Status

The government's executive recruitment guidelines set forth not only criteria in selecting SOE executive candidates but also standards for removing executives. The grounds for dismissal include, for example, failure to meet performance targets in the absence of objective causes, reaching mandatory retirement age, having health problems, serious violation of law such as corruption, or an undertaking of other job responsibilities.[53] The dismissal standards raise questions about post-CEO career development, which is an important dimension of the executive personnel system. For instance, what types of CEOs are more likely to step down due to legal liabilities? Is there any path dependent effect – i.e. staying in the same pathway after the CEO post – in the executive training system of China's SOEs? The existence of path dependent effects signals some predictability in how the state-owner manages its top managers while the non-existence increases the complexity of understanding the executive training system.

As explained previously, CEOs of the single-group track have firm-specific knowledge and insider social connections. The intellectual and social capital can help managers secure not only the CEO position but also other leadership positions such as the chairman of the board in the same group. Thus, the single-group CEOs may be more likely to stay in the same group as they leave the CEO position. If so, there is a path dependent effect in the single-group track on later career development. Similarly, the multi-group track and the unrelated-government-units track may also have path dependent effects as the CEOs of these types possess intellectual and social capital across multiple groups or spheres and thus have advantages in moving across

[53] Chapter 8, Provisional Rules on Corporate Leaders of Central SOEs (2009).

spheres in the government system. The path dependent effect may also happen in the supervisory track. However, since CEOs of the supervisory track tend to be senior in age, retirement would be another common career outcome.

The post-CEO status of the system-outsider track is uncertain. It may depend on how well the system-outsider survives in the state system. Anecdotal evidence suggests system-outsider managers often leave the SOEs very soon due to poor acclimation to the state system. When system-outsiders often quickly retreat from the SOE system, it poses a great challenge to SOE governance improvement through relying on external human resources.

Finally, in addition to staying in the same path or switching to a different trajectory, the post-CEO career development can be disrupted and miserable. As discussed in Section 3.2, corruption control is a major theme in the executive reform schemes. The Chinese party-state has the power not only to promote the CEOs to other higher positions in the government system but also even to punish them to death through its judiciary machinery. While the probability of ending up in jail seems low, it remains quite real as evidenced in a number of recent cases where high-profile executives of China's leading SOEs were ousted and faced with serious criminal liabilities related to their executive duties. A prominent case, for example, is Mr. Tonghai Chen, the ex-CEO of Sinopec Group, was sentenced to death penalty for corruption in 2009.

Because career outcomes are often an accumulation of previous experiences, CEOs coming to power through different career pathways may be at different risks of criminal behavior such as corruption. For example, an intuitive concern of corporate governance is that the unrelated-government-units track may be more likely to have corrupt CEOs due to their more politics-tainted backgrounds and little business management experience. Unlike the unrelated-government track, the single-group track with rich firm-specific knowledge seems less

problematic. But it does not necessarily mean the single-group track would be immune to or at a lower risk of corruption because this track may have the problem of excessive authority concentration and power abuse especially when there is no effective internal monitoring mechanism such as the board of directors.

3.4 Data and Methods

Sections 3.2 and 3.3 above propose the potential change patterns under the executive recruitment reform policies. But as always in China, formal institutional reforms do not guarantee actual changes. To assess the real development of China's SOE executive recruitment under the institutional reforms, this chapter examines the CEO biographic backgrounds of the SOEs among the largest 500 companies (by revenues) in China, according the annual ranking of the China Enterprise Confederation and China Enterprise Directors Association. More than 60% of the largest 500 companies in China are SOEs. An advantage of this ranking is it takes into account the fact that large enterprises in China are organized as business groups in which core companies control a large number of subsidiaries including listed firms. The CEOs of the core companies in the large state-owned business groups are the focus of this chapter. In order to track the effects of the institutional reforms over the past decade, this chapter examines three data years (i.e. 2002, 2005, and 2010) spanning before and after major reform measures. The CEO biographic information is manually collected from multiple sources including corporate prospectuses, annual reports, corporate websites, government documents and websites, industrial association websites, and news reports. After excluding missing data, the sample size of CEO biographical profiles is 272 in 2002, 274 in 2005 and 273 in 2010.[54] The total sample includes 612 distinct CEO profiles.

[54] If no missing data, there would be 352 observations in 2002, 333 in 2005, and 301 in 2010.

This chapter first analyzes descriptive data to show whether the educational, political and career pathway attributes have changed since 2002. The main attributes are as follows: (1) educational attributes: alumni of Tsinghua University (China's best university in engineering), alumni of C9 League (a.k.a. China's Ivy League),[55] engineering degree, graduate degree and foreign degree; (2) political attributes: membership of the Communist Party of China (CPC), age when joining in CPC, membership in the National Congress, Consultative Assembly, or CPC Congress; (3) career attributes: age of becoming the CEO, starting job title in career, types of career pathways, tenure and status after the CEO tenure. When constructing the career pathways, this chapter uses organizations as the basic units to build a sequence and then categorizes the sequence according to the career pathway typology defined in Section 3.3.1. The basic organization units include the core company of the concerning business group (coded as "core"), a subsidiary of the concerning business group (coded as "sub"), an unaffiliated SOE to the concerning business group (coded as "soe"), a supervisory bureau related to the industry matters of the concerning business group (coded as "super"), other government units (coded as "gov"), and a private company (coded as "prv"). All the sequences always end with "core" as the subjects are CEOs of the core companies of the state-owned business groups. With this coding method, for example, if a sequence is sub/sub/core (meaning moving from a subsidiary to another subsidiary then to the core company), the sequence belongs to the single-group track. A sequence of soe/sub/core is an example of the multi-group track; a sequence of super/core belongs to the supervisory track; a sequence of gov/gov/core is an example of the unrelated-

[55] C9 League, formed in 1998, is an alliance of nine prestigious universities handpicked by the Chinese government, including Fudan University, Harbin Institute of Technology, Nanjing University, Peking University, Shanghai Jiao Tong University, Tsinghua University, University of Science and Technology of China, Xi'an Jiao Tong University and Zhejiang University.

government-units track; a sequence of gov/soe/super/core is an example of the multi-sphere track; a sequence of prv/sub/core is an example of the system-outsider track, and so forth.

Second, for each data year, this chapter uses ordinary least squared regression to analyze how certain personal and organizational attributes affect career attainment. Among many possible ways of measuring career attainment, this chapter uses age when appointed as the CEO (i.e. time to the top of the corporate hierarchy) as the dependent variable. This measure allows quantitative analysis and comparison with existing findings in the Western context (Hamori & Karaika 2009). The personal attributes are focused on career pathways and educational backgrounds. Types of career pathways as one of the independent variables are measured as dummy variables with the single-group track as the reference category. Educational credentials are measured as dummy variables, respectively, of whether the executive is a graduate of C9 League (yes=1), whether the executive has an engineering degree, (yes=1), a graduate degree (yes=1), and a foreign degree (yes=1).

In addition to personal factors, different organizational environments may affect career outcomes. Some China's large SOEs recently have started to experiment with launching the board of directors as a device to monitor executives, though there is great doubt about the effectiveness of the board. This chapter tests whether SOEs having established the board of directors may be more active in reform and thus more likely to have younger CEOs, who tend to be less constrained by old traditions. This chapter includes whether the SOE has a board of directors as a dummy variable to take account into this effect. Moreover, considered that SOEs owned by the central government tend to have national importance in the economy and thus have stricter standards in executive quality than SOEs owned by local governments, this chapter includes central government ownership as a dummy variable (yes=1) in the models. For control

variables, firm revenues and assets are included to control for firm size, the number of employees to control for the internal labor market size, and return on assets for profitability.

Third, in order to get a more complete picture of the executive training system, this chapter uses logistic regression models to examine how personal and organizational attributes affect the post-CEO status. The sample size with missing data excluded is 232 CEOs who left office during the period of examination.[56] The dependent variables are five types of immediate post-CEO statuses: (1) the chairman/director/other executive of the same business group; (2) a director/executive of other business groups; (3) a senior official in other government units; (4) a convicted prisoner; or (5) an inactive retiree/decedent. The independent and control variables are similar to those used in the previous models testing the effects on age of career attainment. This chapter is particularly interested to see how the incoming career pathways affect the post-CEO status, such as whether there is a path dependent effect and which career pathway is more likely to produce a CEO ending up in jail. For educational backgrounds, this chapter examines whether better educational credentials such as graduate or foreign education would be associated with certain post-CEO career outcomes. For organizational attributes, this chapter is particularly focused on the effects of the board of directors on the post-CEO status, such as whether SOEs having the board of directors are less likely to have CEOs stepping down in criminal disgrace.

Fourth, this chapter examines the correlation between the executive career pathways and corporate performance. The dependent variables are ROA and ROS in 2002, 2005 and 2010. The independent variables are executive career pathways and educational backgrounds, same as those explained previously. In addition, a number of control variables are included. Since CEOs with a good track of records are more likely to be retained, years in the CEO position is included as a control variable. The board of directors is included as a control variable as it may improve

[56] If no missing data, there should be 319 observations.

performance. The (log) number of employees is to account for firm size. Finally, prior-year performance as the lagged dependent variable is to control for the effect of past performance on the present.

3.5 Results and Analysis

3.5.1 Descriptive CEO Attributes

[Table 16] summarizes the descriptive attributes and change patterns in education, political affiliation and career pathways from 2002 to 2010.

[Table 16]
CEO Attributes of Large State-Owned Non-Financial Enterprises in China, 2002-2010

	2002	2005	2010
General Attributes			
Male	96.7%	96.4%	97.4%
Main Birth Place (i.e. Shandong Province)	13% (N=185)	14.1% (N=206)	11.5% (N=182)
Educational Attributes			
Graduate Degree	37.5%	49.3%	57.1%
Foreign Degree	2.9%	3.3%	4.4%
Tsinghua University	2.9%	2.9%	5.5%
C9 League	15.8%	12.8%	11.4%
Engineering	61.8%	62.8%	66.3%
Political Attributes			
Party Membership			
1. Communist	83.5%	85.4%	80.6%
2. Other	.4%	.4%	.7%
3. Unknown	16.1%	14.2%	18.7%
Average Age When Joining the Communist Party (CPC)	26.4 (N=51)	25.7 (N=66)	25.3 (N=77)
Member of National Congress, National Consultative Assembly, or CPC National Congress[a]	8.1%	11.7%	19.4%
Career Attributes			
Average Age When Becoming CEO	46.4	46.3	46.8
Main Starting Position Title ("Technician")	36.1% (N=158)	33.5% (N=170)	27.8% (N=169)
Career Pathways			
1. Single-Group Track	52.9%	56.2%	52%
2. Multi-Group Track	23.5%	22.6%	24.2%
3. Supervisory-Bureau Track	15.8%	9.1%	12.1%
4. Unrelated-Government Unit Track	3.7%	2.9%	2.2%
5. Multi-Sphere Track	4%	9.1%	9.2%
6. System-Outsider Track	0%	0%	.4%
Tenure	8.8	8.1	NA[c]
Status After CEO Position[b]			NA[c]
1. Chairman/Director/Executive of the Group	27.8%	23.4%	
2. Senior Government Official (e.g., Minister, Governor, Committee Member)	9.2%	4.7%	
3. Director/CEO/Senior Manager of other Groups	5.9%	6.6%	
4. Convicted Prisoner	4%	2.6%	
5. Still CEO of the Group	15.8%	39.1%	
6. Inactive Retiree/Decedent	13.6%	6.6%	
7. Unknown	23.9%	17.2%	
N **(Default, if not specified otherwise)**	**272**	**274**	**273**

[a] The membership is counted as whether the CEO was a member of the legislative bodies of that year.
[b] The post-CEO status was tracked till October 2011.
[c] Because many of the CEOs just took office and 88.6% of the 2010 CEOs are still in power, this measure is not properly applicable.

Educational Attributes. The data show improvement in educational credentials since 2002, which lends support to the view that the professionalism reforms can easily take place in the educational dimension. The percentage of the CEOs with a graduate degree significantly increased to 57.1% in 2010 from 37.5% in 2002. The percentage of the CEOs with a foreign degree also rose, albeit only slightly, to 4.4% in 2010. Those with foreign study experience usually received their degrees from academic institutes in the United States.

As to the academic discipline, surprisingly rather than on a decline, more than 60% of the CEOs were still trained in engineering. The dominance of engineering-trained CEOs is an outcome of China's industrial structure and political history. The Chinese government has been aggressively seeking technological upgrades to move up the value chain. The technological catch-up cannot be achieved by financial or marketing management. Moreover, when China's education was battered by the tempests of Maoism, engineering was a politically safer field of study than most. The supply of talents therefore was more from the field of engineering.

As to the elite school education, while the number of the CEOs who graduated from C9 League declined to 11.4% in 2010 from 15.8% in 2002, the Tsinghua alumni network expanded, accounting for 5.5% in 2010. The elite school network has shrunk and become more concentrated in the leading engineering school in China.

Political Attributes. Regarding political membership, the data show that at least more than 80% of the CEOs are members of the Chinese Communist Party (CCP). This number is significantly higher than the overall employee party membership rate (around 30%) throughout the SOE corporate hierarchy.[57] While one may interpret the CCP membership rate is on the

[57] One-third of the employees in the national SOEs are members of the Party. As of the end of 2009, 3.03 million of the 9.36 million employees of the central SOEs were party members. SASAC (2010).

decline, it is likely an incorrect interpretation given the increase in unknown/missing data.[58] The CCP-affiliated executives joined the Party at a quite early age, around 25-26. It suggests an early pledge of political loyalty is helpful for later-on career development in the state system. Early party membership signals a higher degree of political commitment and also allows a prolonged course of scrutiny, cultivation and training, which thus increases the likelihood of subsequent promotion into elite positions (Li & Walder 2001). While most of the CEOs were CCP members, a very minimal number of the CEOs were affiliated with another political party in China, i.e. China National Democratic Construction Association, an ally of the CCP. The marginal representation of non-CPC party members in the SOE elite adds more symbolic than real importance of political diversity in the SOE system, just like in China's political system.

In addition to the predominance of CCP affiliation, the executive personnel integration into the China's political system seems to be on the rise. The Chinese government has an institutionalized practice in selecting top managers into its representative national political bodies including National People's Congress (the government's symbolic legislative body), the National People's Political Consultative Conference (an advisory body composed of representatives of different social and political groups) and the National Congress of CCP (the Party's general assembly). While usually lack of substantive power, memberships in such political bodies represent a social status or a mark of legitimacy recognized by the party-state. The data show that the number of CEOs who were members of these national political bodies increased from 8.1% in 2002 to 19.4% in 2010. The increased representation suggests the growing importance of the SOEs in China's national political system, but it also deepens the concern about the SOE management autonomy in terms of corporate governance. Overall, the

[58] When a CEO's party affiliation cannot be clearly identified in the multiple information sources, the political affiliation of the CEO is coded as unknown.

political attributes here confirm that political loyalty to the CCP remains a paramount requirement and personnel integration into the national political bodies continues to rise despite the professionalization and marketization reforms.

Career Attributes. On average, the CEOs came to power when they were around 46 years old. "Technician" has been the most common initial job title in the CEOs' careers, though it has declined from 35% in 2002 to 27.2% in 2010 due to more diversity in job titles. This observation is closely related to their educational training, mainly in the engineering discipline.

In respect of career pathways, the single-group track has constantly been the mainstream path. More than 50% of the CEOs came to power through climbing the corporate ladder. The stable majority of the single-group track CEOs suggests that firm-specific knowledge is valued in China's SOE management and insider connections are helpful to secure CEOs positions. Moreover, as many of the state-owned business groups were historically transformed from grouping SOEs along the hierarchical administrative chains, the prevalence of the single-group track may imply the pre-reform promotion logic following the administrative ranks remains in play. The second most common career pathway is the multi-group track, making up for more than 20%. The single-group and the multi-group tracks combined account for more than 75% of the sample observations. In other words, most of the CEOs developed their careers completely within the SOE system rather than moving around in different government spheres. It suggests that party-state maintains a certain degree of separation in human resources training between the political and business spheres within the state system.

The supervisory-bureau track is the next popular pathway, followed by the multi-sphere track and the unrelated-government-units track. Note that there is only a marginal and declining percentage of CEOs coming to power through the unrelated-government-units track. It suggests

the party-state does not favor executive candidates who are unfamiliar with the business matters of the SOE, which is consistent with its professionalization reform rules.

None of the CEOs in 2002 and 2005 followed the system-outsider track. A sign of change emerged in 2010 however. There was one CEO coming to power through the system-outsider track; that was, Mr. Dazong Wang, the CEO of Beijing Automotive Industry Corporation, a SOE under Beijing SASAC's supervision. After completing his PhD from Cornell University, Mr. Wang joined General Motors (GM) and swiftly worked his way up to the top-level position (Senior Staff) of engineering design in GM. After working at GM for 21 years, Mr. Wang joined as a vice president of SAIC Motor Corp., a publicly traded subsidiary of Shanghai Automotive Industry Group, a SOE owned by the Shanghai SASAC. Less than two years of office in SAIC Motor Corp, in 2008 Mr. Wang parachuted onto the CEO position of Beijing Automotive Industry Corporation, a SOE under the Beijing SASAC's supervision. Several implications are noteworthy from this case. First, this case happened in the automobile industry, an industry not monopolized by the state but relatively open to the private sector and foreign companies. Consistent with the expectation in Section 3.3.1, competition pressure in the non-monopoly industry can drive SOEs to recruit system-outsiders to improve innovation capacity. Second, it is a local rather than central SOE that took the initiative to embrace a system-outsider. A partial explanation is the central SOEs are usually of national security importance and thus less open to system-outsiders. It also reflects a typical institutional reform pattern in China – starting from the local. Third, the details of this case provide insights into what incentivizes a system-outsider to join SOEs and by which mechanism a system-outsider can break into the state system. As Mr. Wang himself explained, personal sentiment, family education and patriotism play a significant

role in his decision of joining the SOE system.[59] His internal aspirations were realized with the help of external opportunities. As General Motors sought rapid expansion in China, Mr. Wang seized the opportunity of transferring to a GM's joint venture in China and worked there for three years until 1997. During his work in China, he got acquainted with the then vice president (Mr. Maoyuan Hu) of Shanghai Automotive Industry Group and thereafter kept contacts with Mr. Hu. This social connection paved his way into the Chinese SOE system. Mr. Wang's experience indicates system-insiders' endorsement is very helpful to system-outsiders' entry into the state system, which supports the common finding that personal connections (*quanxi*) play an important role in the Chinese government system (Walder 1995, Bian 1999).

Next, [Table 16] shows that the average tenure is about 8 years. Since the CEOs on average came to power around 46 years old, they were only in their mid-50s at the end of the CEO tenure, an age still capable of active work. Thus, it raises a question about where they would go after the CEO tenure. [Table 16] shows that about a quarter of the CEOs in 2002 and 2005 followed the so-called "apprentice model" in which the CEOs were promoted to the chairman, director or other executive positions of the same business group. The apprentice model allows the CEOs to continue contributing their firm-specific knowledge and to guide their successors before transitioning to retirement.

A featured post-CEO status is transfers to other government units, usually as ministers, governors, or government committee members. But this post-CEO career status seems to be on

[59] A detailed interview reported in Qicheren (Autobots, a magazine of China's automobile industry), Nov. 2008 (reporting Mr. Wang's explanation : "A man should not forget his own roots. A man who does not know his own roots is a pathetic one. …I am a traditional Chinese. … From a personal perspective, I am really grateful to my father. My life philosophies are all inherited from my father. I seldom see any person who is as patriotic as my father. I always remember my father said repetitively at his death bed that we should learn in the United State and apply in China. … My father studied in Japan. Upon returning to China he established the first ceramics high school and the first ceramics factory for home appliances in China, becoming the founder of China's contemporary ceramics industry. The old intellectual's scientific patriotism is deeply passed down to his next generation. What leads me is such philosophy. Like my father said, I can contribute by applying in China and simultaneously broaden my career horizon.")

the decline, down from 9.2% in 2002 to 4.7% in 2005. Close to 6% of the CEOs took up senior manager positions in other business groups, which suggests the government's personnel rotation practice is at work in post-CEO careers.

As SASAC's executive recruitment reform rules repetitively emphasize executives' moral integrity, the post-CEO status shows how many CEOs ended up in jail on charges related to their executive positions and duties. The data show that 4% of the CEOs in 2002 and 2.6% in 2005 were faced with criminal liabilities in relation to their executive duties. The typical criminal charges were corruption and embezzlement. The decline in criminal convictions seems to suggest some improvement in moral integrity, albeit inconclusively because many factors such as politics could affect the prosecution probabilities in China. As most of the executives are party members, their criminal conduct often would be resolved by the Party's internal investigation and sanction without proceeding to the criminal law stage (Sapio 2010). [60] Moreover, while there were a number of CEOs held liable for corruption or embezzlement under the Chinese criminal law, none of the CEOs in the dataset ever became defendants in litigations involving breach of fiduciary duties under the Chinese company law. The Chinese government as the controlling shareholder seems to govern the top managers in a way similar to government bureaucrats, who are subject to liabilities under public law such as criminal law.

As of the end of data tracking, 15.8% of the CEOs in 2002 and 39.1% in 2005 were still in office. Finally, at least 13.6% in 2002 and 6.2% in 2005 were identified as inactive retirees or decedents while 23.9% in 2002 and 17.2% in 2005 were with unknown post-CEO status. The

[60] In China, there are two parallel systems to punish criminal conduct: one for party members and the other formal criminal procedure. When a party member is suspected of a crime, the party member is subject to the party's internal investigation first. Sapio (2010) explains that the party's discipline rues replicate the state's criminal law, though the party's rules redefine criminal offences as "mistakes" or "minor infractions" that do not involve criminal liabilities. To avoid causing social insecurity, the party hands over to the courts only a small percentage of party members who have received party sanctions. In 2009, for example, over 1,300,000 cases of corruption by party members were reported to the party's discipline organs; but, only 140,000 were filed for party investigation, of which over 100,000 were punished internally. No number was given for the cases eventually proceeded to formal criminal prosecution.

unknown status is due to the fact that biographical information tends to become obscure when the CEOs left office, especially for those without moving to prominent positions.

3.5.2 Executive Attributes in Comparative Perspective

How are the CEOs of the Chinese large SOEs different from corporate executives in other countries? Based on the descriptive findings in [Table 17], this section compares Chinese SOE CEOs with executives of the archetype countries in comparative capitalism and comparative corporate governance literatures, including France of the state activism camp, Japan and Germany of the coordinated market and stakeholder-oriented model, and the UK and US of the liberal market and shareholder-oriented model (Hall & Soskice 2001, Schmidt 2003). [Table 17] shows a general summary of the executive attributives in comparative perspective.

[Table 17]
Executive Attributes in Comparative Perspective

	State Activism		Coordinated Market / Stakeholder Oriented		Liberal Market / Shareholder-Oriented	
	China (SOEs only)	France	Japan	Germany	UK	USA
Education Attributes						
Dominant Educational Discipline	Engineering or natural science (more than 60% with an increasing trend)	Engineering or natural science (more than 30% as of 2005), followed by business, economics or administration	Engineering or natural science (more than 30% as of 2011); law, economics	Engineering or natural science (more than 50% as of 2005)	Business	Business
Elite School Concentration	C9 League, particularly Tsinghua University	Grandes École, particularly Polytechnique and École Nationale d'Administration	Tokyo, Kyoto, Waseda and Keio	No specific concentration	Cambridge and Oxford	Ivy League and a number of elite schools (about 13 in total), with Harvard University as the lead
Degree of Elite School Concentration	Low (about 11% as of 2010)	High (about 75% as of 2005)	High (about 60% as of 2009)	Low	Moderate-High (about 40% as of 2007)	Moderate (more than 20% as of 2011)
Career Attributes						
Prevailing Career Pathway	Singe-group pathway within the state system (More than 50%)	Lengthy careers in state service before transfer to business	Singe-group pathway	Singe-group pathway (more than 55% as of 2005)	Multi-employer pathway	Multi-employer pathway (less than a third as lifetime employees)
Work Experience in Government	When broadly defined (SOEs as part of government): Very High (More than 99%) When narrowly defined (only government units other than SOEs): Moderate (about 20%)	Moderate-High (More than 50% in 1998 down to 38% in 2005)	Low-Moderate	Low	Low	Low
Approximate Age of Appointment	Mid-Late 40s	Early 50s	Mid-Late 50s	Early 50s	Early 50s	Early 50s
Average Tenure	About 8 years , with a declining trend	About 8 years (as of 2011)	About 6 years in 2007, down from 8 years in 1995	About 8 years, with a declining trend down from 12 years in 1980	About 6-7 years (as of 2011) down from 9.6 in 1995	About 8 years down from 10 years from 2010.
Apprenticeship Model in Training CEOs	Low-Moderate (About 25%)	Low†	High	Low†	Low†	Moderate-High (43% as of 2011)

Data on France from Vivien A. Schmidt, Vivien A*, A Profile of the French CEO*, 35 INT'L EXECUTIVE 413 (1993); Taeyoung Yoo and Soo Hee Lee, *In Search of Social Capital in State-Activist Capitalism: Elite Networks in France and Korea*, 30 ORG. STUD. 529 (2009); Mairi Maclean, Charles Harvey, and Jon Press, BUSINESS ELITE AND CORPORATE GOVERNANCE IN FRANCE AND THE UK (2006); Booz & Company, CEO SUCCESSION REPORT: 12TH ANNUAL GLOBAL CEO SUCCESSION STUDY (2012). Data on Japan from Booz & Company, CEO SUCCESSION 2000-2009: A DECADE OF CONVERGENCE AND COMPRESSION (2010); Booz & Company, CEP SUCCESSION 2008: STABILITY IN THE STORM (2009); Booz & Company, CEO SUCCESSION REPORT 2003: THE PERILS OF "GOOD" GOVERNANCE (2004); Booz & Company, CEO SUCCESSION REPORT: 12TH ANNUAL GLOBAL CEO SUCCESSION STUDY (2012). Data on Germany from Saskia Freye, *Germany's New Top Managers? The Corporate Elite in Flux, 1960–2005*, MPIfG Discussion Paper 10/10, 2010; Booz & Company, CEO SUCCESSION REPORT: 12TH ANNUAL GLOBAL CEO SUCCESSION STUDY (2012); Paul Windolf, CORPORATE NETWORKS IN EUROPE AND THE UNITED STATES (2002). Data on United States from Peter Cappelli and Monica Hamori, *The New Path to the Top*, 83 HARV. BUS. REV. (2005); Richard S Tedlow, Purrington, Courtney and Bettcher, Kim Eric, *The American CEO in the Twentieth Century: Demography and Career Path*, Harvard Business School Working Paper No. 03-097, 2003; Jeffrey S. Sanders, *The Path To Becoming A Fortune 500 CEO*, FORBES, December 2011; Booz & Company, CEO SUCCESSION REPORT: 12TH ANNUAL GLOBAL CEO SUCCESSION STUDY (2012); Jason D. Schloetzer & Matteo Tonello, The 2011 CEO SUCCESSION REPORT (2011) † Booz&Co (2012) reports at the overall European level, rather than on specific countries

[Table 17] shows that CEOs of the state activism and the stakeholder-oriented models are commonly trained in engineering while those of the shareholder-oriented model tend to be in

business-related disciplines. The dominance of engineering-trained CEOs is most salient in China and Germany. With respect to the alumni network, China and Germany both are on the low end of elite school concentration while France and Japan are on the high end, with US and UK in between.

As to career pathways, the prevailing career route in China, Japan, and Germany is climbing the corporate ladder to the top within a single-business group while the popular career track in UK and US is to follow an external labor market strategy. In France, government work experience is quite common: a significant number of CEOs started their careers in the public sector before transferring to the corporate sector. In Japan, while many executives follow the so-called *amakudari* career pathway, most of them do not assume CEO positions. It seems that the CEOs of China's SOEs are closest to French CEOs in terms of their career connections with the government.

As to the average age of appointment, the CEOs of China's SOEs come to power at a younger age (around 46 years old) than CEOs in the other countries, usually in their 50s. This junior CEO phenomenon in China is consistent with the party-state's executive professionalization agenda – intentionally to recruit young executives, who are more enthusiastic and less constrained by old traditions. But there is no sharp difference in terms of tenure, currently in the range of 6-8 years with a trend of shortening in length. Finally, unlike Japan and US where outgoing CEOs are commonly appointed as the chairman of the same company, China only moderately uses the apprentice model in training and guiding CEOs, somewhat similar to the European counterparts. The moderate use of the apprentice model in China may be partially due to the fact that many Chinese SOEs have yet established the board of directors.

Overall, [Table 17] shows the CEOs of China's large SOEs bear a resemblance to executives in countries of the stakeholder-oriented model and the state activism camp, though the resemblance is probably formed by different underlying historical or political forces. The CEOs of China's SOEs are least like the executives of the shareholder-oriented model. The Chinese CEOs share many similar attributes particularly with German CEOs while having the least in common with UK and US counterparts. This comparison clearly places China far outside the category of the liberal market economy or the shareholder-oriented model.

3.5.3 How Do Personal and Organizational Attributes Affect Age of Attainment?

[Table18] shows the results about how certain personal and organizational attributes are associated with age of reaching the CEO position in the period of 2002-2010.

[Table 18]
OLS Regression Analysis of Executive Career Pathways and Age of Attainment, 2002-2010

	Dependent Variable: Age When Becoming the CEO					
	2002		2005		2010	
	(1)	(2)	(3)	(4)	(5)	(6)
Career Pathways						
1. Single-Group Track	----------Omitted as Reference Category----------					
2. Multi-Group Track	1.316 (.999)	.950 (.944)	1.406 (.932)	1.425 (.925)	4.143*** (.776)	3.679*** (.774)
3. Supervisory-Bureau Track	3.903** (1.123)	3.549** (1.046)	3.766* (1.443)	3.029* (1.209)	4.480*** (1.127)	4.443*** (1.070)
4. Unrelated-Government-Units Track	2.487 (1.571)	1.630 (1.465)	1.999 (2.149)	1.854 (1.571)	5.191** (1.804)	4.620** (1.635)
5. Multi-Sphere Track	2.742 (1.508)	1.462 (1.759)	2.264* (1.104)	2.109† (1.103)	3.313* (1.406)	2.691* (1.177)
6. System-Outsider Track[a]					11.105*** (1.314)	11.465*** (1.374)
Educational Backgrounds						
C9 League	-.567 (1.020)	-1.109 (1.030)	.439 (1.017)	-.185 (1.127)	-.532 (.846)	-1.363 (.872)
Engineering	3.087*** (.823)	1.249 (.832)	1.434 (.829)	.248 (.826)	.564 (.790)	-.167 (.741)
Graduate Degree	-2.836*** (.788)	-3.300*** (.727)	-.711 (.749)	-.634 (.730)	-1.024 (.708)	-.418 (.684
Foreign Study	4.881† (2.605)	3.322 (2.393)	.913 (1.711)	-.140 (1.178)	-1.839 (1.350)	-2.364† (1.370)
Organizational Controls						
Board of Directors (Yes=1)		1.270 (1.017)		-1.264 (.949)		-1.616 (.375)
Ownership (Central Gov.=1)		2.973* (1.222)		1.495 (1.097)		1.049 (.964)
Log Revenues		.499 (.443)		.292 (.522)		.502 (.505)
Log Employees		1.201*** (.328)		.892* (.399)		.607 (.375)
Return on Assets		-.115 (.117)		-.143 (.103)		-.147 (.124)
Constant	44.367*** (.910)	26.211*** (4.729)	44.693*** (.939)	33.311*** (6.368)	45.193*** (.908)	33.139*** (6.046)
Observations	272	263	274	272	273	270
Adjusted R-squared	.122	.284	.049	.157	.145	.250

The table presents unstandardized coefficients with robust standard errors in parentheses.
Significance Level: † p<.1 * p < .05; ** p < .01; *** p < .001.
[a] The system-outsider category is omitted for the years of 2002 and 2005 because there is no observation falling into this category

While the distribution of the types of career pathways in [Table 16] is quite stable over the period of investigation, [Table 18] shows that the nature of the career pathways has changed in terms of age of career attainment. Models 1-2 show the results of 2001, with Model 2 as the full model including all the independent and control variables. Model 2 shows that in 2001 CEOs coming to power via the supervisory-bureau pathway were significantly older (b=3.549, p<.01)

at the time of appointment than CEOs through the single-group pathway, and CEOs via the multi-group, unrelated-government-units and the multi-sphere pathways were older as well, albeit not statistically significant.

Models 3-4 show the results of 2005, with Model 4 as the full model. Models 3-4 both show that in 2005 the single-group career CEOs reached the executive position at a younger age compared to the CEOs of all other types of career pathways, but the result for the multi-group and the unrelated-government-units pathways are not significant. The trend became clearer in 2010, as shown in Models 5-6. Both the models show that CEOs coming to power through the single-group pathway were significantly younger than CEOs of all other types of career pathways. Among all the types, the system-outsiders were the oldest ($b=11.465$, $p<.001$ in Model 6) when ascending to power. The results lend support to the hypothesis that system-outsiders need to have established external reputation and high professional status, usually already senior in age, to overcome their liability of foreignness when entering into the state system.

Note that the CEOs of the supervisory-bureau track were constantly older as they landed on the executive position, which can be explained by the retirement strategy as discussed in Section 3.3.1.

Overall, the career pathway results suggest that firm-specific knowledge and insider social networks have become significantly valuable for executive career attainment in China's SOEs. [Table 18] shows a career trend converging to the findings in the Western counterparts. Scholars found that in Europe and in the United States, CEOs with in-house careers spent significantly less time to the top compared to those adopting external labor market strategies (Hamori & Kararika 2009).

Regarding the value of education, [Table 18] shows that elite school attendance was not a significant factor in age of career attainment. Neither was an engineering degree a significant factor (Models 2, 4, 6). The 2002 data suggest having a graduate degree was helpful to reaching the CEO positions at a younger age, but the 2005 and 2010 data indicate a weakening of that advantage. This could be because the value of graduate degrees has diminished as more and more executive candidates have such degrees. This could also be because pursuing a graduate degree postponed the entry into the workforce or distracted energy from work and thus delayed promotions. Foreign education does not accelerate to the CEO position in 2002 but it seems help in 2010 ($b=-2.364$, $p<.1$).

For organizational variables, while the board of directors has been advocated as an important governance reform of China's SOEs, [Table 18] shows that the board of directors plays an insignificant role in affecting age of executive appointment (Models 2,4,6). This finding lends some support to the common observation that the real player on the stage of Chinese SOE governance is the Party in the shadow rather than the corporate board in the light.

Moreover, [Table 18] shows that executives of the SOEs owned by the central government tend to reach the CEO position at an older age compared to those of the SOEs owned by the local governments, though the result is significant only for 2002 ($b=2.973$, $p<.05$). An institutional explanation for this finding is the executive positions of the central SOEs have a higher status in the administrative system and thus it takes longer time to reach the higher positions.

For control variables, [Table 18] shows that CEOs of the SOEs with larger numbers of employees tend to be older at the time of appointment, which may be because of more

competition in the internal labor market. Other organizational variables including revenues and return on assets do not present statistically significant effects on the executive appointment age.

3.5.4 How Do Personal and Organizational Attributes Affect the Post-CEO Status?

[Table 19] shows the effects of personal and organizational attributes on the post-CEO status. The questions of concern here are whether there is a path dependent effect in post-CEO career development and what attributes are important in predicting having a criminally convicted CEO at the end.

[Table 19]
Logistic Regression Analysis of Post-CEO Status, 2002-2010

	Post-CEO Career Status									
	Chairman/Director/Executive of the Same Group		Director/Executive of Other Groups		Senior Government Official		Convicted Prisoner		Inactive Retirees/Decedent	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Career Pathways										
1. Single-Group Track	---------REF---------		-.689 (.620)	-.379 (.663)	-.575 (.603)	-.644 (.660)	---------REF---------		---------REF---------	
2. Multi-Group Track	-.439 (.340)	-.350 (.364)	---------REF---------		-.500 (.645)	-.365 (.690)	.566 (.678)	1.302 (.778)	.374 (.484)	-.042 (.560)
3. Supervisory-Bureau Track	-.808 (.483)	-.628 (.510)	.762 (.739)	.869 (.768)	---------REF---------		.104 (.907)	.824 (.982)	.076 (.626)	-.667 (.740)
4. Unrelated-Government-Units Track	-1.364 (.754)	-1.455 (.799)	1.919 (.805)	2.623** (.917)	.424 (.870)	.610 (1.025)	-14.721 (.638)	-17.021 (4909.2)	-.831 (1.196)	-.861 (1.346)
5. Multi-Sphere Track	-.398 (.574)	-.535 (.621)	1.250 (.784)	1.326 (.848)	-.599 (.936)	-.872 (1.047)	.104 (.920)	2.166 (1.293)	-.1883 (1.142)	-.326 (2.537)
6. System-Outsider Track[a]										
Educational Backgrounds										
C9 League	1.095* (.436)	1.210* (.480)	.173 (.633)	.190 (.654)	-1.311 (.769)	-1.018 (.808)	-.827 (1.260)	-16.387 (2647.8)	-1.504 (.776)	-1.856* (.885)
Engineering	-.016 (.314)	-.167 (.343)	.110 (.517)	.233 (.564)	.665 (.433)	.421 (.480)	-1.548 (.574)	-2.170** (.746)	.166 (.476)	.795 (.568)
Graduate Degree	.699* (.302)	.618 (.313)	-.180 (.520)	-.125 (.537)	.071 (.384)	.042 (.408)	-.995 (.677)	-1.419 (.803)	-.804 (.508)	-.645 (.577)
Foreign Study	-1.129† (.674)	-.899 (.752)	3.088*** (.766)	2.659** (.826)	-.944 (1.094)	-.445 (1.140)	-13.847*** (.729)	-14.717 (5246.9)	-1.866 (1.282)	-2.914* (1.370)
Organizational Variables										
Board of Directors (Yes=1)		1.234** (.398)		-.796 (.593)		-1.032* (.510)		.739 (.880)		-1.274 (.661)
Ownership (Central Gov.=1)		.580 (.447)		.155 (.688)		-1.398* (.652)		-.807 (1.113)		.297 (.711)
Log Revenues		-.011 (.155)		.150 (.242)		.185 (.214)		-.430 (.361)		-.232 (.253)
Log Employees		.166 (.154)		-.183 (.200)		.447* (.217)		.578 (.335)		-.646 (.223)
Return on Assets		.060 (.042)		-.075 (.078)		-.100 (.074)		.059 (.069)		-.005 (.068)
Life course control										
Age at Appointment	-.055* (.025)	-.071* (.028)	-.070 (.040)	-.087* (.044)	-.074* (.032)	-.097* (.038)	.046 (.047)	.070 (.060)	.269*** (.048)	.311*** (.058)
Constant	2.395 (1.230)	.468 (1.995)	-.028 (1.558)	1.196 (3.142)	1.304 (1.467)	-3.472** (2.683)	-3.912 (2.182)	-5.541 (4.526)	-13.931 (2.493)	-6.066 (3.672)
Observations	232	229	232	229	232	229	232	229	232	229
x^2 (df)	30.22 (9)	43.32 (14)	31.37 (9)	33.56 (14)	12.80 (9)	27.05 (14)	15.12 (9)	26.58 (14)	69.37 (9)	95.50 (14)
p-value	.000	.000	.000	.002	.186	.019	.088	.022	.000	.000

The table presents unstandardized coefficients with standard errors in parentheses.
Significance Level: † p<.1; * p < .05; ** p < .01; *** p < .001.
a The system-outsider category is omitted because there is no observation falling into this category.

The career pathway variable shows that there is no clear path dependent effect in the post-CEO career development. CEOs of the single-group track are not statistically significantly more likely to stay in the same group (Models 1 and 2). Meanwhile, CEOs of the multi-group group are not significantly more likely to transfer to other groups (Models 3 and 4). Similarly, CEOs who had work experience in other government units are not significantly more likely to return to government bureaus (Models 5 and 6). The lack of clear path dependent effects suggests the complexity and unpredictability in the elite training system.

An interesting finding about the association between the incoming career pathway and the outgoing career status might be CEOs of the unrelated-government-units track are less likely to be subject to criminal charges at the end of the CEO position, though the results are not statistically significant (Models 7 and 8). This finding may be interpreted in two ways. On the one hand, it might relieve a common concern that such type of CEOs are more likely to mismanage corporate governance and incur criminal liability for corruption because they have more politics-tainted backgrounds and little business experience. On the other hand, this finding could suggest that CEOs of the unrelated-government-units track might be simply more politics-savvy in managing their careers in the state system and have more political resources to get away from legal liabilities, which is not a good sign for corporate governance. Finally, this Article does not find CEOs of the supervisory-bureau track tend to transition to inactive retirees after the CEO tenure, which does not support the hypothesis in Section 3.3.2.

For educational attributes, [Table 19] shows that CEOs who graduated from the elite schools are more likely to stay in the same group (Models 1 and 2) and less likely to end up in prison (Model 8, b= 16.387). Engineering-trained CEOs are also less likely to be criminally convicted after the CEO position (Model 8, b= -2.160, $p<.01$). CEOs with a graduate degree are

also less likely to be criminally convicted after the CEO tenure, though the result is not significant. Foreign-educated CEOs are more likely to transfer to positions in other business groups (Models 3 and 4) while less likely to commit crimes such as corruption (Models 7 and 8). In general, [Table 19] shows that better education is negatively associated with the likelihood of having a criminally-liable CEO at the end. Improvement in executive educational credentials may be a good sign for the quality of leadership.

As to organizational variables, CEOs in the SOEs which have set up the board of directors are more likely to assume the chairman, director or other executive positions in the same business group ($b=1.234$, $p<.01$). The result is unsurprising given that the transition to the chairman or director position is only possible when a board exists in the group. Moreover, the presence of the board of directors reduces the likelihood of becoming a senior official in government bureaus ($b= -1.032$, $p<.05$), which suggests the board might play role in untangling political connections. However, the board of directors fails to play an effective role in reducing the likelihood of (outrageous) executive criminal behavior ($b= .739$). This finding suggests the monitoring function of the board of directors is not properly at work. [Table 19] also shows that CEOs of the central SOEs are less likely to transfer to government bureaus after tenure, compared to CEOs of the local ones ($b= -1.398$, $p<.05$). The post-CEO personnel integration between the SOEs and other government units seems higher at the local than the central level.

Finally, for control variables, neither the size of revenues nor return on assets is an insignificant factor in predicting the post-CEO status. The number of employees is significantly and positively associated with the government official status but not with other post-CEO statuses.

3.5.5 Executive Attributes and Firm Performance

[Table 20] shows that SOEs with CEOs of the unrelated-government-unit pathway have the worst performance in ROA and ROS, compared with SOEs with CEOs of other types. The results are statistically significant for ROA albeit generally not significant for ROS. It suggests political career CEOs do not help corporate performance. Note that the system-outsider track has the best performance among all other types (Model 5, b=4.228, p<.01; Model 6, b=1.055; Model 11, b=2.473; Model 12, b=1.691, p<.05), which indicates that outsiders may bring new management knowledge to improve firm efficiency.

[Table 20]
Executive Attributes and Firm Performance

	Performance											
	ROA						ROS					
	2002	2002	2005	2005	2010	2010	2002	2002	2005	2005	2010	2010
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
CEO Individual Attributes												
Career Pathways												
1 Single-Group Track	2.385***	1.120*	2.216**	.482*	2.197**	.382	.721	1.361†	1.419	.354	1.813	1.012†
	(.653)	(.507)	(.750)	(.239)	(.695)	(.267)	(1.260)	(.804)	(1.605)	(.321)	(1.870)	(.535)
2 Multi-Group Track	1.307*	.724	3.180**	.660*	2.412**	.654*	.368	.657	2.610	.306	1.754	.950†
	(.577)	(.479)	(.943)	(.309)	(.715)	(.321)	(1.395)	(.827)	(1.719)	(.382)	(1.830)	(.482)
3 Supervisory-Bureau Track	1.757*	.466	1.827*	.276	2.431**	.114	.006	.251	2.630	.306	2.180	.375
	(.842)	(.539)	(.825)	(.245)	(.841)	(.337)	(1.310)	(.829)	(1.826)	(.346)	(1.856)	(.507)
4 Unrelated-Gov.-Units Track												
5 Multi-Sphere Track	1.912	1.097†	2.836*	.323	1.771*	.465	1.749	.768	2.120	-.207	1.704	.509
	(1.129)	(.577)	(1.122)	(.361)	(.817)	(.340)	(1.964)	(1.032)	(1.843)	(.474)	(1.843)	(.692)
6 System-Outsider Track※					4.228**	1.055					2.473	1.691*
					(1.477)	(.712)					(2.556)	(.752)
Educational Backgrounds												
C9 League	.628	.529	-.622	.280	-.549	-.252	.325	.220	.531	.386	1.060	.362
	(674)	(.464)	(.500)	(.230)	(.405)	(.237)	(.901)	(.512)	(.966)	(.274)	(1.434)	(.745)
Engineering	-.677	.540	-.544	.351	-.192	.358	.032	.342	-.299	.443†	.002	.323
	(.565)	(.324)	(.537)	(.266)	(.417)	(.248)	(.695)	(.382)	(.639)	(.255)	(.699)	(.400)
Graduate Degree	-.008	-.251	.165	.197	.184	.167	-.742	-.415	.428	.368	.508	.003
	(.547)	(.411)	(.454)	(.251)	(.402)	(.204)	(.626)	(.421)	(.503)	(.248)	(.570)	(.318)
Foreign Study	-1.507**	.153	.030	-.253	1.589	.216	-.483	.513	.604	-.578†	.894	.208
	(.464)	(.550)	(1.000)	(.278)	(1.517)	(.740)	(.834)	(.737)	(1.807)	(.332)	(2.000)	(.684)
Years in CEO Position	.181**	.037	.124*	.017	.147**	.048*	.165*	.041	.073	.027	.114	.037
	(.050)	(.036)	(.060)	(.025)	(.052)	(.023)	(.078)	(.047)	(,073)	(.027)	(.099)	(.043)
Organizational Attributes												
Board of Directors		.016		-.302		-.439†		.236		-.299		-.153
		(.486)		(.297)		(.260)		(.577)		(.291)		(.497)
Ownership (Central Gov.=1)		-.560		-.607*		-.359		.038		-.213		-.353
		(.502)		(.266)		(.258)		(.594)		(.321)		(.498)
Log Number of Employees		.072		-.119		-.002		.024		-.175†		-.017
		(.172)		(.093)		(.075)		(.159)		(.089)		(.136)
Prior Performance (Lagged Dependent Variable)		.787***		.878***		.873***		.716***		.848***		.902***
		(.075)		(.047)		(.050)		(.057)		(.045)		(.099)
Constant	.843	-.945	.475	1.196	.581	.188	3.066	-.351	1.171	1.752†	1.250	-.391
	(.636)	(2.063)	(.771)	(.920)	(.706)	(.897)	(1.253)	(2.021)	(1.659)	(.892)	(1.840)	(1.306)
Observations	226	224	273	272	271	261	228	226	273	272	271	261
R-squared	.074	.451	.053	.802	.071	.770	.047	.598	.027	.863	.021	.722

The table presents unstandardized coefficients with robust standard errors in parentheses.
+ p < .1; * p < .05; ** p < .01; *** p < .001
※ No observation in the system-outsider track category for 2002 and 2005.

[Table 20] also shows that SOEs with a long-tenure CEO have better performance, especially for ROA. The finding supports the hypothesis that well-performing CEOs are likely to be retained and continue deliver good performance.

While the establishment of the board of directors is regarded as an important reform to improve corporate governance, the results in [Table 20] do not promise a positive effect on firm performance. Central government ownership and employment size are insignificant factors for corporate performance. Finally, prior year performance is significantly associated with present year performance. The regression models in [Table 20] do not have the problem of heteroscedasticity.

3.6 Implications

This chapter shows the executive recruitment of China's large SOEs is oriented toward politically-bounded and firm-specific knowledge professsionalism as well as potential bottom-up and competition-driven marketization. It also shows a convergence toward Western findings where the single-group pathway abundant with firm-specific knowledge and insider social connections is emerging as an advantageous route in executive career attainment. Moreover, this chapter shows the complexity of the Chinese elite training system, where there is no clear path dependent effect on the post-CEO status and there is no conclusively bad association between political career experience and executive criminal liabilities. This chapter also finds little evidence that the board of directors of China's SOEs plays any significant role in affecting executive career development or avoiding serious executive criminal behavior. Finally, this chapter shows SOEs with political career CEOs tend to have worst performance. Based on the findings, this Article discusses the legal implications for the international capital market, the

challenges posed to China's SOEs particularly through the lens of social network theory, and the directions for future research.

3.6.1 Legal Implications for the International Capital Market

SOEs, not just from China but many other emerging markets, have become important international investors. As of the end of 2010, there were at least 650 state-owned transnational companies controlling more than 8,500 foreign affiliates across the globe. While relatively small in number (less than 1% of all transnational companies), their foreign direct investment (FDI) is substantial, reaching roughly 11% of global FDI flows in 2010 (UNCTAD 2011). The global expansion of SOEs raises questions to international investors and regulators about the adequacy of existing rules and enforcement in dealing with this new type of companies.

Judging by current international securities standards, do Chinese SOEs' corporate disclosures to international investors provide an adequate and accurate depiction of their actual governance practices? Chinese SOEs always in their corporate disclosures significantly downplay their connections to the Chinese government and its ruling political party. The role of the government is very often condensed in one simple sentence -- the company is owned by the State, and the role of the Chinese Communist Party is virtually never mentioned. Chinese SOEs rarely disclose in their prospectuses or annual reports the top managers' membership in the Party and their affiliation with the national representative political bodies. The executive biographies in such disclosures are focused on business experiences but void of political backgrounds, intentionally making the top executive look similar to their Western counterparts. Also, they never disclose the fact that the appointment power is actually with the Chinese Communist Party not the board of directors. Furthermore, there is no disclosure that the top managers are prohibited from freely exercising stock options because of the SOE personnel integration with

other government units. In short, a significant amount of material information is omitted or misrepresented. While the lack of adequate disclosure is mainly a result of the secretive culture of the Chinese government, it is also an outcome partly of calculated advice by Western investment bankers, law firms and accounting firms to make Chinese SOEs attractive to international investors (McGregor 2010, Walter & Howie 2003) and international securities regulators' generally loose enforcement against foreign companies, regardless of state-owned companies or not (Siegel 2005).

With the global expansion of SOEs, international regulators are now often considering how to appropriately define and identify an SOE under relevant laws, particularly in the regime of anti-trust and foreign investment laws. The findings in this chapter provide an additional and tangible way of how to identity a SOE. While over the past decade the Chinese government has reduced its ownership stake in many SOEs, the executive personnel integration with some important government organs have been increasing rather than decreasing at the same time. In other words, the size of ownership stake alone is an insufficient indicator to precisely judge the potential degree of state involvement in the management of SOEs. The executive personnel integration with the state system can be an important indicator of evaluating the extent of the government involvement as well as corporate investment purposes driven by top managers' political career orientation.

3.6.2 Challenges for Corporate Governance Improvement

The empirical evidence in this chapter shows that the business elite of the Chinese large SOEs are a very cohesive group in terms of their educational training, political affiliation and career experience. The current executive labor market remains a system-insider's game. The elite cohesion presents advantages and challenges to Chinese corporate governance and national economy.

According to sociologist Ron Burt's analysis of "brokerage and closure" in social structure, while high cohesion can help consensus formation and policy implementation, it runs risks of closure, groupthink and lack of creativity (Burt 2007). Building brokerage ties reaching outside the closed system can import new ideas and stimulate innovation. As competition in the global economy has become more dependent on innovation capacity, Chinese SOEs in order to gain a competition edge need more inputs of new talents and new management skills. The Chinese government seems to be aware of the potential closure problems and thus intends to build brokerage ties through opening the executive labor market.

In the eyes of the Party, neither complete closure nor complete openness is desirable because complete closure lacks competitiveness and complete openness runs the risk of losing control. It will take time for the Chinese government to learn how to strike a balance between closure and openness. The openness of the executive labor market probably will start from lower-level managers to high level-managers, from the business groups owned by the local governments to those controlled by the central government, from companies faced with fierce competition pressure to companies in the monopolized sectors. But the whole process will develop slowly because personnel management remains a highly sensitive area and the Chinese

government still takes it as the most important way to continue its control over the large enterprises as the government reduces its ownership stakes.

Moreover, while China's SOEs have a demand for professionals who are trained outside the state system, the executive reform process can be conditioned by the supply side of talents -- how system-outsiders are interested in joining the SOEs. According to SASAC officials, it happened several times in the past where they extended offers to system-outsiders but the candidates declined the offers because the pay was way below the market price.[61] To handle this problem, the Chinese government is experimenting with a dual system in executive compensation. Under the dual system, system-insiders as in tradition get a pay unilaterally set by SASAC's evaluation while system-outsiders are paid based on market prices through contract negotiation. The latter compensation is usually much higher than the former. It is unclear whether such dualism will work well because anecdotal evidence shows that it can brew resentment among system insiders.[62] In addition, the SOE management culture typically tainted with political complexities may make system-outsiders shy away from joining the state system. As a result, the executive labor market probably will continue to be dominated by system-insiders for a long time, which increases the risks of perpetuating old practices including sidestepping the board of directors in major corporate governance matters.

[61] For example, Mr. Jigang Jiang, the Director of central SASAC's Second Executive Administration Bureau, explained that "In 2005, there was a candidate who studied aboard and worked in a foreign multinational company and then transferred to the CEO position of the multinational's branch in China. The candidate applied for a vice CEO position of a central SOE. He passed the written exam and interviews with the highest scores. We really wanted to hire him, but the hiring goal was not realized due to compensation gaps. The candidate asked for a pay at least on par with his current pay ($200,000 USD). The candidate was very sincere and said he was motivated by patriotism and the passion to contribute to the development of central SOEs, so he did not ask for any pay raise but hoped to stay on his current level. The deal was eventually killed because the asking pay in fact was equal to the total compensation of the other seven top managers of the hiring SOE." See Beijing News, *Forty Percent of the Central SOE Executives Recruited Worldwide are from Inside the System*, May 2011.
[62] Id.

CHAPTER 4

TIGHT AND LOOSE CONNECTIONS TO THE FINANCIAL WORLD

4.1 Introduction

The availability of financial capital is an important factor in corporate growth. Industrial firms can use internal and external sources to support capital needs. Very often industrial firms cannot merely rely on internal profits to satisfy their capital demands but extremely need to resort to external financial sources. The relationship between industrial firms and financial institutes thus plays a critical role in affecting firm performance and ultimately national economic development.

Existing literature has provided evidence showing industrial firms in major capitalisms often build dense and direct ownership and/or directorship relations with financial institutions (especially banks) as a means to manage resource dependence and reduce uncertainties. For example, the Japanese horizontal post-war *keiretsu* were bank-centered business groups. In the *keiretsu*'s heyday, the large commercial bank (known as the main bank) as the central actor in the business network provided security in financial resources as well as monitoring in management through its lending, ownership and board connections with member companies (Aoki &1994). But as Japanese industrial firms have had more financing alternatives to bank loans, their ties with banks have been unwinding since the past decade (Schaede 2006, Lincoln & Shimotani 2010). In the United States, for most part of the twentieth century, commercial banks occupied the central position of the interlocking directorship network of the large companies (Mizruchi 1982). But since the late 1980s, the market-based system has overtaken the credit-based system as the major financing channel; commercial banks have become less central in the

interfirm network (Davis & Mizruchi 1999). The centrality of banks and financial institutions in the corporate network can also be found in many advanced and transition economies (Scott 1991 for a review, Aguilera 1998, Pahor et al. 2004).

Does the commonly observed phenomenon of bank centrality exist in the corporate network of China's SOEs? Do Chinese industrial SOEs use ownership and/or personnel ties with banks to secure or strengthen access to financial resources? This chapter shows that there are weak and sparse ownership and personnel connections but strong capital flows between the financial and non-financial SOEs. Chinese industrial SOEs do not use straight ownership or personnel ties to co-opt financial institutions as commonly found in other capitalist or transition regimes. The industrial SOEs' financial resources are secured through vertical and other hidden connections ultimately leading to the party-state. The Chinese SOE network presents party-state centrality rather than bank centrality.

4.2 Weak Ownership Connections

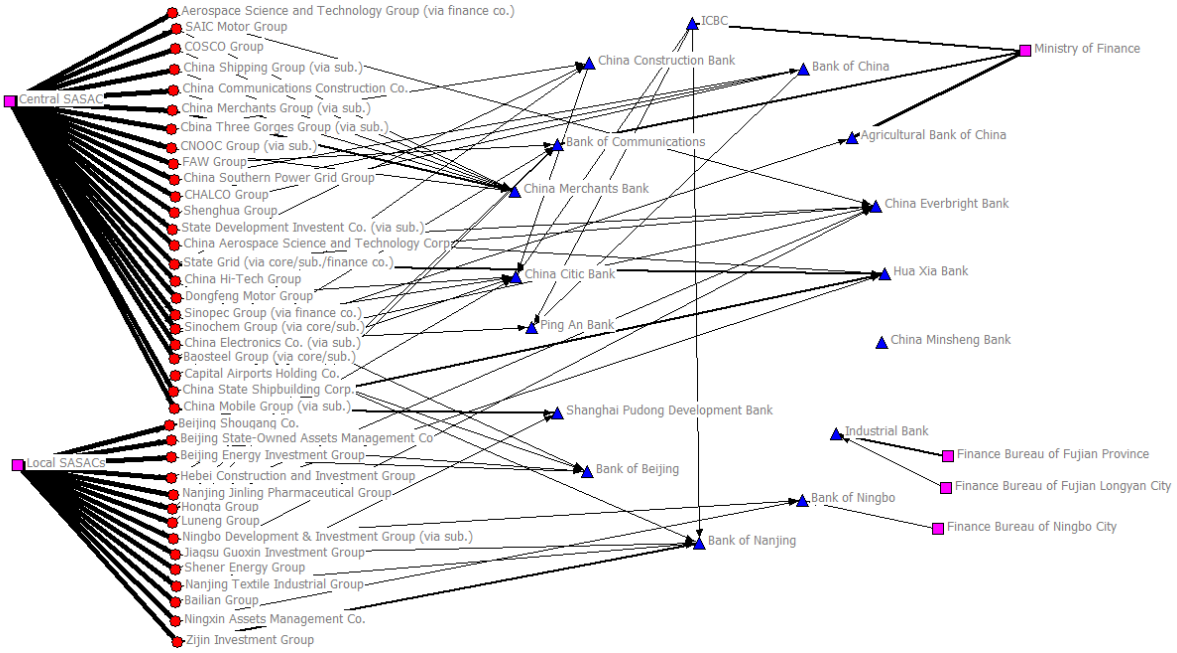
Banks are the central institutions in China's financial system (Walter and Howie 2011). Prior to 1978, the Chinese banking system comprised only one bank – the People's Bank of China (PBOC). In the era of China's planned economy, the PBOC assumed comprehensive roles in the national financial system including managing monetary policy, revenue collection and allocation. The modernization of the Chinese banking system began in 1978. The PBOC gradually transformed into China's central bank and transferred its commercial banking functions to subsequently-established big four banks. The big four banks include Bank of China, China Construction Bank, Agricultural Bank of China, and Industrial and Commercial Bank of China. In addition to the big four banks, there are twelve second-tier commercial banks and more than a hundred city commercial banks in the third tier. Besides the commercial banks,

there are three policy banks responsible for financing national economic development projects. All the three policy banks are directly and wholly-owned by the central government.

[Figure 13] shows the ownership network of existing sixteen publicly-traded commercial banks in China. Of the 117 national groups under the central SASAC, only 24 groups have an ownership stake in these major banks, with an average minority stake of 2.9 percent (median =1.3 percent). And of the multi-hundreds of state-owned groups under the local SASACs, only 14 groups have an ownership connection to these major banks, on average holding a minority stake of 4.86 percent (median=1.93 percent).

[Figure 13]

Ownership Network of Chinese Major Banks and Industrial SOEs (2012)



Source: raw data collected from the top 10 shareholder information published by the16 publicly traded banks (2012). The network only reports the banks' ownership connections with the SOEs under the central and local SASACs' control. Besides these reported connections, the banks have ownership ties to 21 financial institutions and 32 private/foreign institutions.

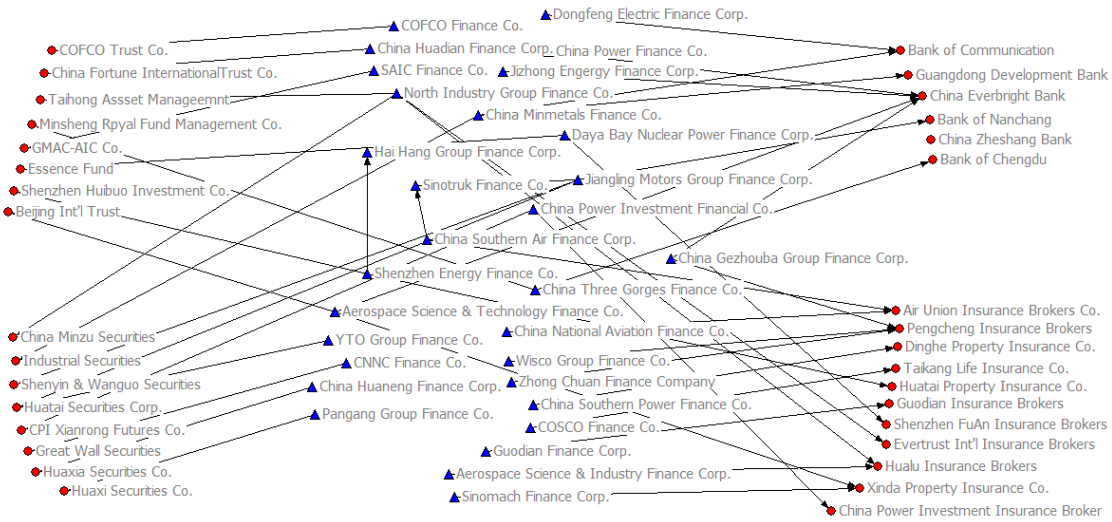
The loose ownership connection between the state-owned industrial groups and the major banks is a calculated decision by Chinese policymakers. Under the Chinese legal system, Chinese banks are prohibited from owning stakes in non-banking financial institutions and industrial companies while industrial groups are discouraged (albeit legally allowed) from holding controlling stakes in banks.[63] The ownership separation is designed to reduce risks given the immature management and regulatory condition both in the financial industry and the state-owned sector.

But in recent years, many industrial SOEs have been gradually expanding into the financial industry territory, especially by using finance companies as a portal to the financial world, as shown in [Figure 14]. The finance companies act as an experimental learning device for industrial SOEs to gain know-how of the financial industry. It is a process that gradually combines industry and finance. This ownership connection pattern permitted by Chinese policymakers essentially reflects the predominant economic reform principles in China – experimentalism and gradualism (Woo 1999).

[63] Lending Rules and Law of Commercial Banks, Article 43.

[Figure 14]

State-Owned Finance Companies' Investment in Financial Institutes (2009)



Source: raw data collected from Almanac of Finance Companies in China (2010).
Note: There are 31 finance companies (blue triangle nodes) in the graph. If X company has an ownership stake in Y company, it is denoted as X→Y.

4.3 Separate but Cohesive Elite Groups

Corporate elite networks can facilitate resources flows and promote class cohesion (Mizruchi 1996, Useem 1980). The most studied type of corporate elite networks is formed by interlocking directorships (Koenig and Gogel 1981, Mizruchi 1982, Useem 1984, Mizruchi 1996, Kono et al., 1998, Davis, Yoo, Baker 2003). Existing research shows that there are relatively few interlocking directorates among Chinese listed companies and sparse interlocks with financial institutions (Ren et al. 2009). Beyond the listed companies, the core companies of the large state-owned business groups also have very few interlocks as many of the core companies themselves do not even have a board of directors. At present, interlocking boards do not act as a mechanism connecting the financial and non-financial elite in the Chinese state-owned sector.

Another important mechanism to form the corporate elite network is through interfirm career movements (i.e. career pathways). Interfirm mobility helps mutual understanding in organization management and creates social channels to facilitate resource exchanges. Dense career connections to the major banks strengthen the industrial SOEs' access to financial resources while sparse connections indicate specialization is an important principle in the elite training system and the industrial SOEs reply on other mechanisms to secure financial capital from the banks.

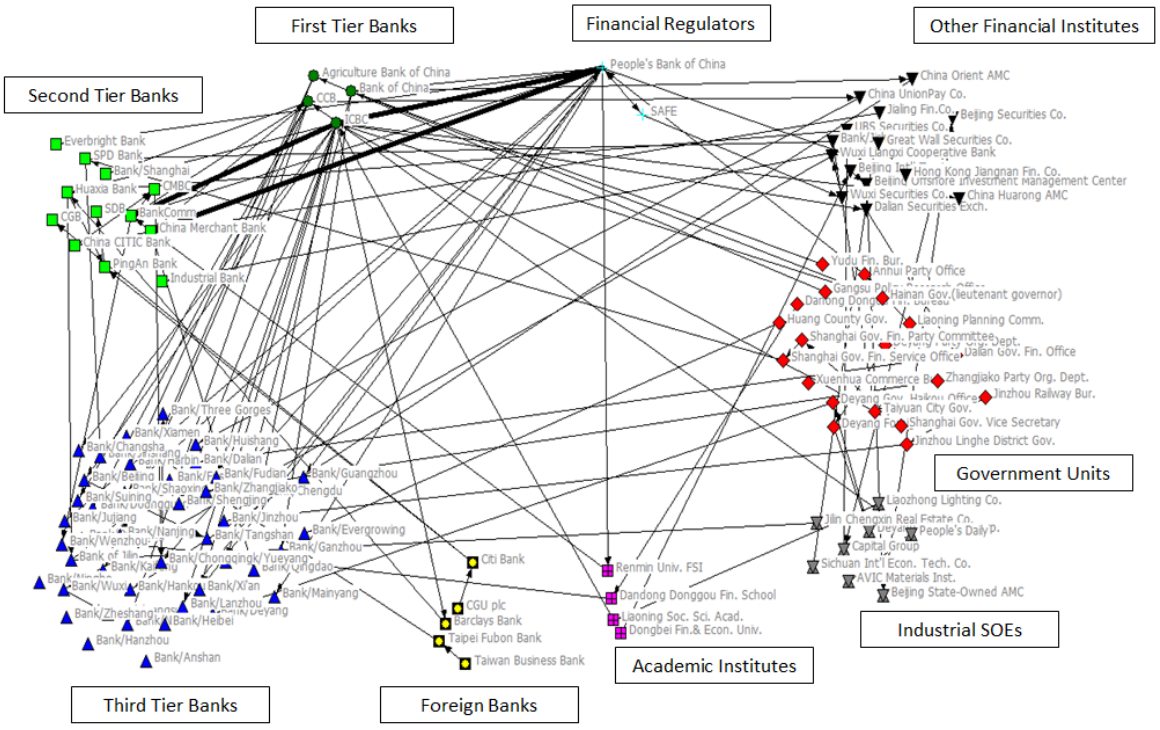
This chapter collects and analyzes data on executive career pathways of the major banks to assess the scale of the elite career network across the financial and non-financial SOEs. The sample includes 58 unique executive profiles as of 2011 covering the CEOs of the big 4 banks, the 12 second-tier banks and 42 third-tier banks.[64] The bank executive background data are manually collected from multiple sources including corporate annual reports, securities prospectuses, corporate and government websites. To ensure information reliability, each executive career profile is based on at least two information sources.

A career pathway is constructed as a directed sequence composed of movements across organizations. The organizations are categorized into several types based on the nature and status of the organization, including: financial regulatory institution, first-tier bank, second-tier bank, third-tier bank, foreign bank, industrial SOE, academic institution, other government bureau, and other financial institution. Each CEO has his/her own organizational sequence (e.g., People's Bank of China (financial regulatory institution) →Bank of China (first-tier bank) → Bank of Shanghai (second-tier bank)). Using social network analysis, all the career pathways can be organized into a career network graph.

[64] Without missing data, there would be 144 CEO profiles for the third-tier banks as of the end of 2011.

[Figure 15] shows the career network composed of the career pathways of the 58 bank CEOs. The network includes merely 8 industrial SOEs and only 7 executive career pathways ever crossing at least one of the industrial SOEs. The executive interfirm mobility takes place mainly between organizations within the financial industry. There are only sparse career connections across the major banks and the industrial SOEs. Thus, the career network seems to play a marginal role in facilitating resources exchanges across the major banks and the industrial SOEs in China.

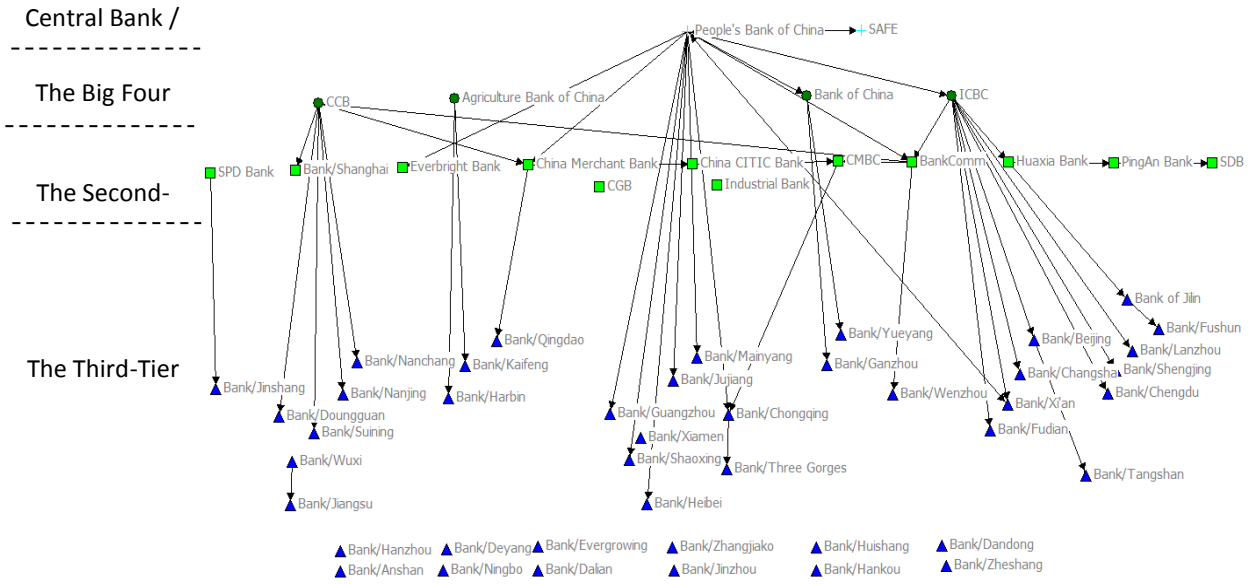
[Figure 15]
Bank CEO Career Network (2011)



Furthermore, when focusing on the relations among the major banks alone (by removing other types of organizations from [Figure 15]), there appears a hierarchically-descending pattern in the bank elite's interfirm job movements—moving from a higher-status organization to a lower status organization in the banking industry, as shown in [Figure 16].

[Figure 16]

Bank CEO Network Career with Non-Bank Institutes Removed (2011)



To confirm this hierarchically-descending pattern, this chapter adopts a "frequent sequence mining" method in the field of computer science to find the most frequent executive career patterns in the banking sector. The details of the sequence mining method are explained in Appendix. With this frequent sequence mining strategy, the most common career patterns are reported in [Table 21].

[Table 21]
Bank CEO Attributes (2011)

	Tier 1 Bank CEOs	Tier 2 Bank CEOs	Tier 3 Bank CEOs	Total
Career Attributes				
Most Common Career Pathways (by length k-subsequence)	Length 2-Subsequence: Tier 1 Bank → Tier 1 Bank (3 paths =75%)† Government Bureau → Tier 1 Bank (2 paths =50%)†	Length 2-Subsequences: Regulatory Financial Institution → Tier 2 Bank (6 paths=50%)† Tier 1 Bank → Tier 2 Bank (4 paths) Tier 2 Bank → Tier 2 Bank (4 paths)	Length 2-Subsequences: Tier 1 Bank → Tier 3 Bank (21 paths=50%)† Regulatory Financial Institution → Tier 3 Bank (11 paths) Government Bureau → Tier 3 Bank (8 paths)	Length 2-Subsequences: Tier 1 Bank→ Tier3 Bank (21 paths) Regulatory Financial Institution → Tier3 Bank (11 paths) Government Bureau → Tier 3 Bank (8 paths) Regulatory Financial Institution → Tier 2 Bank (7 paths) Tier 1 Bank → Tier2 Bank (6 paths)
Average Age When Becoming CEO	52.5	50.8	44.7	46.4
Gender (Male)	100%	100%	92.9%	94.8%
Educational				
Graduate Degree	100%	75%	81.3%	72.4%
Foreign Degree	25%	25%	4.8%	10.3%
Tsinghua University	0%	0%	2.4%	1.7%
C9 League	25%	8.3%	11.9%	12.1%
Business	100%	83.3%	88.1%	87.9%
Political				
Party Membership				
1. CPC Member	100%	83.3%	90.5%	89.7%
2. Others/Unknown	0%	16.7%	9.5%	10.3%
Average Age When Joining the CPC	21 (N=2)	--	26.2 (N=5)	24.7 (N=7)
Members of National Congress, National Consultative Assembly, or CPC National Congress	75%	16.7%	0%	8.6%
Observations	4	12	42	58

†this pattern is with *minsup* >=50%.

[Table 21] shows that the most common career pattern for the CEOs of the first-tier banks (i.e. the big four banks) is a sequence of job movements from a first-tier bank to another first-tier bank. The second popular pattern is movements from a local government to a first-tier bank. The executive career pathways of the top tier banks present a lateral-training and an administrative-training movement pattern rather than a descending movement pattern along the hierarchy of the banking industry. But the hierarchically-descending pattern clearly exists for the

CEOs of the second-tier and third-tier banks. The common career movement pattern for the second-tier bank CEOs is from the financial regulatory institution (i.e., the People's Bank of China, the central bank) to a second-tier bank. The popular pattern for the third-tier bank CEOs is from a first-tier bank to a third-tier bank. The hierarchically-descending career pattern suggests that the elite training system of the banking industry values the management knowledge of higher-status organizations and diffuses such knowledge from the higher to the lower organizations. It is a top-down oriented learning and training network.

Besides the career pathways, [Table 21] also shows other executive career, educational and political attributes of the major banks in China. The executives of the higher-tier banks tend to be older when assuming their positions because it takes more time to reach the higher-status positions.

In terms of education, a great majority of the bank CEOs at all tiers have a business-related degree and a graduate degree. The CEOs of the first- and second-tier banks are more likely to have overseas study experience than those of the third-tier banks, which suggests foreign education may be more important for higher-status banks as they have more international business. Only a small minority of the CEOs received their college degrees from the elite university in China, which may be partially explained by the fact that the reputation of the top Chinese universities is built on engineering rather than business. In terms of political backgrounds, a dominant majority of the bank CEOs are members of the Chinese Communist Party. Moreover, the top-tier CEOs are significantly more likely to be members of the major national political assemblies than lower-tier CEOs, which is explainable as the candidacy in these national representative bodies is linked with social, political and economic status.

To further examine the executive relations across the financial and non-financial SOEs, [Table 22] compares the CEO attributes of the two elite groups of the state-owned sector. There are great similarities between the bank and industrial CEOs. Both elite groups present the dominance of male CEOs. A majority of the bank and industrial CEOs have a graduate degree (57.1% for the industrial CEOs and 72.4% for the bank CEOs) but foreign-educated CEOs remain a small minority (5.5% for the industrial CEOs and 10.3% for the bank CEOs). Elite school dominance does not exist in the composition of both elite groups; only a little more than 10% of the CEOs were alumni of the Chinese elite universities. In terms of political backgrounds, most of the bank and industrial CEOs are members of the Chinese Communist Party and joined the party at a quite early age, around 25 years old. Both elite groups show connections with the three national political representative bodies, with a greater percentage (19.4%) of the industrial CEOs affiliated with these political assembles.

[Table 22]
CEO Attributes Comparison

	Industrial SOE CEO (2010)	Bank CEOs (2011)
Gender (Male)	97.4%	94.8%
Education		
Graduate Degree	57.1%	72.4%
Foreign Degree	4.4%	10.3%
Tsinghua University	5.5%	1.7%
C9 League	11.4%	12.1%
Business	---	87.9%
Engineering	66.3%	---
Political		
Party Membership		
1. CPC Member	80.6%	89.7%
2. Others/Unknown	19.4%	10.3%
Average Age When Joining the CPC	25.3 (N=77)	24.7(N=7)
Members of National Congress, National Consultative Assembly, or CPC National Congress	19.4%	8.6%
Career Attributes		
Work Experience in Finance	.07%	---
Work Experience in Industrial SOEs	---	12.1%
Average Age When Becoming CEO	46.8	46.4
Most Common Career Pathway	Single-Group Path (in-group ascending path)	Hierarchical-Descending Path
Observations	273	58

The composition of the two elite groups presents not only cohesion but also specialization. A majority (66.3%) of the industrial CEOs are educated in engineering-related fields and most (89.7%) of the bank CEOs are in business-related fields. Relatedly, only 0.7% of the industrial CEOs have ever worked in financial institutions and 12.1% of the bank CEOs ever in industrial SOEs. Cross-sector career experience is rare. The extreme rareness of the industrial CEOs entering into the financial sector suggests that the Chinese government manages the financial sector with great caution.

The divergent career pathways also reflect the specialization feature. The most common career pathway for the industrial CEOs is climbing the corporate ladder from the bottom to the

top within a single business group. Such industrial CEOs possess a good volume of group-specific knowledge. Unlike the industrial CEOs, the most frequent career pathway for the bank CEOs follows a hierarchically-descending pattern across organizations within the banking industry. Compared to industrial production management, financial knowledge tends to be more generalized across organizations. Such knowledge mobility allows more interfirm career movements in the banking industry. The bank CEOs thus tend to have industry-wide rather than group-specific knowledge.

Overall, the composition of the bank and industrial CEOs demonstrates a high degree of cohesion and specialization. The financial and non-financial executives have many shared identities that promote class cohesion but at the same time possess specialized skills to maintain certain management rationality of the state-owned sector. The sparse personnel connections between the financial and industrial SOEs reflect the specialization in the elite training system and also indicate that the flow of financial resources is not secured through the personnel network but something else.

4.4 Strong Capital Flows through the Hidden Ultimate Connection

The loose ownership and personnel connections between the industrial SOEs and the major banks prove that the bank-centrality phenomenon does not exist in the Chinese state-owned corporate network. The industrial SOEs do not use direct ownership or personnel connection to the banks to secure financial resources. However, the industrial SOEs enjoy endless flows of money from the major banks, absorbing more than 80% of bank loans in China (Chiu & Liews 2006, Cary 2013). The coordination mechanism between the industrial and the financial giants obviously is not reliant on direct lateral shareholding or personnel exchanges. The coordination in reality works through vertical relations that ultimately tie the financial and

non-financial SOEs together to a common entity: the party-state. At the national level, the central industrial groups are supervised by the central SASAC and the large banks are controlled by the Ministry of Finance, and both the central SASAC and the Ministry of Finance are controlled by the State Council and interchangeably the Party. The State Council itself is the critical coordination connection between the industrial and financial SOEs. Similar vertical connections are present at the local government level. The local governments own local industrial SOEs through their own SASACs and control local city commercial banks through their financial bureaus. The formal vertical ownership ties give the local governments coordination powers over the local SOEs and the local city commercial banks. Although Chinese local governments do not have ownership stakes in the major state-owned banks (e.g., the big four banks), the local officials have *de facto* appointments powers over bank executive positions of the banks' branch offices and have close social ties with the branch managers (Tsai 2004). The local governments through these information connections can readily direct capital to the industrial SOEs under their control.

As all the important industrial SOEs and banks have direct or indirect ties to the same owner, the industrial SOEs can easily secure their financial resources through the ultimate common connection. It practically makes the use of immediate ownership or personnel connections across the financial and industrial worlds redundant. Furthermore, when resource availability is guaranteed through the ultimate common connection, the major concern for the state as the owner and as the policymaker shifts toward risk control in the system. The sparse lateral ownership and personnel connections between the industrial SOEs and the major banks help to reduce management complexity and risk connectivity of the state-owner sector, which is of particular importance as both the industrial and financial SOEs are suffering from their own

management problems. Such lack of lateral connections at the same time reinforces the vertical control of the party- state. Unlike other capitalisms, the corporate network in China's state-owned sector is characteristic of "party-state centrality" rather than "bank-centrality."

CHAPTER 5

INTERNATIONAL CONNECTIONS: SOURCES OF GOVERNANCE CHANGE?

5.1 Introduction

China is not only a strong magnet for foreign direct investment (FDI) but also becomes a significant source of FDI. The Chinese government's "going global" policy, formally adopted in 2001, ushered in China's remarkable increase in outward investment. China's outward FDI flow has increased from $915 million in 2000 to $84 billion in 2012 (World Investment Report 2013), ranking at the third largest country in the world, behind United States and Japan. This astonishing growth in outward FDI is mainly contributed by Chinese SOEs. As of 2011, the SOEs accounted for *at least* 62.7% of China's non-financial outward investment stock (Ministry of Commerce 2011).[65]

Under the "going global" policy, Chinese SOEs have gone on a shopping spree to acquire companies abroad. Their global expansion, however, often faces challenges and concerns in host countries. One of the common concerns is the governance of Chinese SOEs has low transparency and often deviates from internationally-recognized corporate governance standards. Some host countries such as Australia, Canada and USA have welcomed Chinese SOEs with great caution through regulatory reviews. As China's SOEs continue to globalize, it raises an important question about how their governance would change. Specifically speaking, can mergers and acquisitions that connect China's SOEs with foreign companies/investors and

[65] This is a conservative estimation. According to the Ministry of Commerce's data, wholly-state-owned enterprises accounted for 62.7%, limited liability companies for 24.9%, joint stock limited liability companies for 7.6%, private enterprises 1.7%, joint-stock partnerships 1.6%, foreign firms 0.9%, collective enterprises 0.2%, firms from Hong Kong, Macau and Taiwan 0.2% and others 0.2%. But many limited liability companies and joint stock limited liability companies are also wholly-state-owned or state-controlled. It has been estimated actually about 85-90% were contributed by state-owned or state-controlled enterprises (Development Research Center of State Council 2013).

expose them to foreign institutions serve as an effective mechanism for Chinese SOEs to learn and converge on the prevailing international corporate governance practices?

The pursuit of this question is not only of practical importance for international investors and regulators with the view to develop investment relationships with China's SOEs but also of academic significance in several disciplines. First, corporate governance scholars have a perennial debate on the future of national corporate governance systems (Gorden and Roe 2004) – will they converge on a universal model (especially the shareholder-oriented model or the Anglo-Saxon model) or will they continue to retain their national differences? According to the convergence school, capital market integration through cross-border mergers and acquisitions as well as overseas listing is a strong driver of convergence in governance (Yoshikwa and Rasheed 2009). International mergers and acquisitions connect firms of different governance systems and often require changes in the governance structure of acquiring or acquired firms, or both. Overseas listing connects the listing firm to foreign investors and requires the firm to adopt governance rules set by the foreign stock exchange and relevant regulators, which makes the governance structure of the listing firm converge on the foreign model (Coffee 2002). Unlike the convergence school, the persistence school would predict little convergence for the SOEs embedded in China's idiosyncratic state capitalism. But recent SOE reforms in China such as launching the board of directors and institutionalizing independent directors have indicated at least some formal convergence (Gilson 2001) or de jure convergence (Khanna, Kogan, Palepu 2006). Ostensibly, such convergence appears encouraging evidence to the convergence theory. However, it remains unclear whether internationalization is an apt explanation for this governance change. Empirically, at the firm level, do we observe that more internationalized

SOEs, especially through equity connections with foreign companies/investors, are more likely to reform their corporate governance structure?

Second, as noted by scholars of international business, extant research on multinational firms unfortunately has limited integration with corporate governance (Wu and Tihanyi 2013). The most researched area in the topic of corporate governance in multinational firms is internationalization strategy. Researchers show that ownership structure (Bhaumik et al. 2009, Benito et al. 2011), board composition (Filatotchev et al. 2001, Lien et al. 2005), top management team (Tihanyi et al. 2000) and executive compensation (Sanders 2004) have an impact on the degree of internationalization. But there is a research lacuna regarding how the governance of headquarters in the home country may change as a result of internationalization. An investigation of how China's SOEs may reform in governance as they globalize is an attempt to fill this void.

This chapter uses insights derived from network studies and institutional theory to evaluate the relationship between Chinese SOEs' internationalization and their governance reform patterns. The empirical findings in this chapter indicate that the degree of globalization (measured by the number of acquisitions, the number of joint ventures, overseas revenues, and overseas listing) seems virtually irrelevant to the reform patterns of the SOEs under the central SASAC's supervision. This chapter offers two possible explanations for the absence of correlation between internationalization and governance reform. First, the investment structure and investment geography pose obstacles to transmitting positive outward investment impact on the core company in the group. Second, more importantly, the governance reform is a result more of the government's central planning than market behavior decided at the firm level. It lends support to the central argument in this dissertation – to fully understand Chinese SOEs'

governance or behavior, we need to look beyond the individual firm and analyze the organizational network in which the firm is embedded. It seems that the Chinese state-owner does not take the degree of internationalization at the firm level as a relevant factor in setting the reform pace for the SOEs under their control. But how the Chinese state-owner selected the governance reform candidates remains a black box.

5.2 **Analytical Framework**

Investment is relational in the sense that it creates not only flows of money but also channels of influence. The relational nature of investment becomes particularly complex for overseas investment across different institutional environments. Scholars of international business have shown how the institutional distance between the home country and the host country would affect a firm's entry modes or contract governance arrangements as well as subsequent performance of the investment vehicle in the host country (e.g., Abdi and Aulakh 2012, Cui and Jiang 2012). In addition, international business scholars are concerned about the spillover effects of inward FDI on the capacity of domestic companies and institutions in the host country, especially debating whether multinational companies headquartered in advanced economies would import positive or impose negative effects on the local institutions of less developed economies (Javorcik 2004). Current international business literature, however, understudies how a company's outward investment would create inbound influence on the company itself as well as potential spillover effects on the institutional qualities of the home country. The inattention is explainable as the dominant players in the global investment market traditionally have been firms in advanced economies that have little reason to emulate immature institutions of less developed economies. But as firms in less developed economies have emerged as important players in global outward investment, how their outward investment

activities may influence their internal governance now turns to be a question worthy of exploration. As Chinese SOEs are investing globally, how do their international investment connections influence their internal corporate governance practices?

Institutional theory suggests an organization's behavior is influenced by the economic, legal and political environments in which it operates. The environments create normative forces that drive how an organization should operate, regardless of whether the organization has particular concerns that might make such structures useful to its functioning (Tolbert & Zucker 1983, DiMaggio & Powell1983, Meyer &Rowan 1977). Conformity to institutional expectations helps the organization acquire legitimacy. Different environments impose different normative pressures and thus produce different organizational structures and behavior. When an organization born and operating in a certain environment enters into a new environment, it may be under normative pressure to change its organizational structures or behavior so as to adapt to and establish legitimacy in the new environment. The normative pressure may be more intense when the new environment is dissimilar from the original environment.

As different countries have different institutional environments, this institutional approach suggests an interactive effect between an SOE's country of origin and the SOE's investment country in predicting the potential of SOE corporate governance change. In other words, the institutional distance between the origin country and the destination country of investment matters in evaluating the potential of SOE governance change. While there are many dimensions of institutional environments, this chapter is focused only on corporate governance institutions. The basic idea is presented in [Table 23] below.

[Table 23]
Institutional Distance and SOE Governance Change Potential

		Destination Country	
		Strong Corporate Governance Regime	**Weak Corporate Governance Regime**
Origin Country	**Strong Corporate Governance Regime**	(High) *Institutional match* → Little need/pressure to change/improve governance	(High) *Institutional mismatch* →Little inbound influence on governance, but potentially positive effects along FDI on destination countries
	Weak Corporate Governance Regime	(High) *Institutional mismatch* → High suspicion and pressure to change	(High) *Institutional match* → Little need/pressure to change/improve governance

For analytical convenience, a country can either be a (relatively) strong governance regime or a (relatively) weak governance regime. Admittedly, this dichotomous categorization may be oversimplified given the complexity of assessing the quality of corporate governance institutions. Several attempts to compare corporate governance across countries through quantitative indicators (LLSV 1998, Martynova and Renneboog 2010, Global Competitive Reports 2001-2014 from World Economic Forum, Country Rankings from Governance Metrics International 2009) have been subject to cautions and criticisms (Spamann 2010, Bhagat et al. 2008, Aguilera and Desender 2012). The quantitative governance indices present limitations and inconsistencies among themselves, nevertheless, their results constantly show that most developed countries rank high on the indices and most developing countries including China gravitate toward the bottom. There should be little controversy if China is placed in the weak governance category and developed countries such as United States, United Kingdom, and Australia in the strong governance category.

When both the origin country and the destination country are in the same type of governance regime (either strong or weak), it is called there is *institutional match* between them.

If there is a high degree of institutional match, there would be of little normative pressure on the investing SOE or the investing state-owner to change the SOE governance practices. In other words, there would be only marginal inbound influence from such outward investment. The institutional match provides a comfort zone for the SOE to continue its traditional practices even when they operate across national boundaries. The upper left cell and the lower right cell in [Table 23] show the scenarios of institutional match. The upper left cell shows a scenario in which an SOE from a strong corporate governance regime invests in a parallel regime. An example is Norsk Hydro, a Norwegian SOE, invests in Sweden. The lower right cell shows a situation where an SOE from a weak governance regime invests in another weak regime, such as Sinopec, a Chinese SOE, investing in Nigeria.

To the contrary, when there is a high degree of *institutional mismatch* between the origin country and the destination country, institutional conformity would be a source of pressure to change governance practices. But the direction of governance impact runs in different ways depending on where the better institutions are located. The upper right cell in [Table 23] illustrates a situation where a SOE from a strong governance regime invests in a poor regime. An example is Norsk Hydro invests in Algeria. The governance impact tends to run in the direction from the better regime to the poor regime. The governance implication of this type of investment has been well-examined in the FDI literature concerning how FDI from advanced economies benefit domestic firms and institutional development of emerging markets (Görg and Greenaway 2004, Aitken and Harrison 1999, Smarzynska Javorcik 2004, Dang, 2013).

The lower left cell in [Table 23] illustrates a scenario where a SOE from a weak governance regime invests in a strong regime, such as Sinopec investing in the United States. A number of advanced economies such as Australia, Canada and the United States have regulatory

review processes to ensure foreign investments are consistent with national interests. Compared to investments by foreign private companies, investments by foreign government-controlled entities are subject to higher/additional regulatory review standards given that they have greater potential to harm national interests of the host country.[66] One of the common review standards is to assess whether the SOE's corporate governance is in place to ensure management independence from the government's control.[67] While the investment review systems are based on statues or regulations, the actual operation of the review processes is more of politics than law because governments have considerable discretion in interpreting the meaning of "national

[66] Foreign investment in Australia is regulated under the Foreign Acquisitions and Takeovers Act 1975 (the FATA) and by the Australian Government's Foreign Investment Policy (the Policy). The Policy provides the framework for Government scrutiny of proposed foreign investment while the FATA, together with the Foreign Acquisitions and Takeovers Regulations 1989, sets out which types of foreign investment proposal require notification to or prior approval by the Government, and provides monetary thresholds below which the relevant FATA provisions do not apply Investment Policy (the Policy). In Australia, *all* investments by foreign government controlled entities are subject to the prior notification requirement, regardless of investment size. For more details about the Australian regulatory system and assessment, see Andrew Shearer and Mark Thirlwell, Is the Foreign Investment Review Board Acting Fairly?, Australia Open Investment Future (AOIF) Paper 4, Dec. 2008, http://www.ipa.org.au/library/publication/1229471411_document_thirwell_updated.pdf.

In Canada, the regulatory regime operates under the Investment Canada Act. When a foreign investor acquires control of a Canadian business and the asset value of the Canadian business being acquired equals or exceeds a certain threshold, the foreign investor must prove that the investment is of net benefit to Canada. In December 2007, Industry Canada promulgated SOE Guidelines under the Investment Canada Act partly as a reaction to growing public concerns over foreign SOEs' acquisition of controlling stakes in prominent Canadian businesses. In 2009, the Investment Canada Act was amended to allow the government to block foreign investments based on national security concerns. Very recently in December 2012, the Canadian government further revised the review guidelines for foreign SOE investment to increase scrutiny over investment by foreign SOEs, along with the announcement of approving the high-profile and contentious acquisitions by Petronas and CNOOC.

In the United States, parties to a transaction that could result in control of a U.S. business by a foreign person may file a notice with the Committee on Foreign Investment in the United States (CFIUS) to determine whether such transaction would present any national security risks. Foreign government controlled transactions is an important factor of whether CFIUS would initiate an investigation. See Guidance Concerning the National Security Review Conducted by CFIUS http://www.treasury.gov/resource-center/international/foreign-investment/Documents/CFIUSGuidance.pdf.

[67] The Foreign Investment Review Board (the Board) of Australia good corporate governance is one of the obligations that investors should undertake. See http://www.firb.gov.au/content/who.asp?NavID=48. The Guidelines on Investment by State-Owned Enterprises, released by Industry Canada, include: "The governance and commercial orientation of SOEs are considered in determining whether reviewable acquisitions of control in Canada by the SOE are of net benefit to Canada;" and "this examination will include whether the non-Canadian adheres to Canadian standards of corporate governance, and to Canadian laws and practices." Guidance Concerning the National Security Review Conducted by CFIUS take "whether corporate governance structures are in place to ensure management independence from the controlling government" as a factor in evaluating the risk to national security.

interests", "net benefits" and "national security."[68] As a result, foreign SOEs may face not only legal but also political pressure to change governance. This case of institutional mismatch has the greatest potential of positive inbound influence flowing from the host country back to the headquarters and home country. This chapter labels this investment relation as *positive institutional mismatch*, where there may be positive inward influence derived from the outward investment.

The basic idea of [Table 23] suggests China's SOEs are more likely to adopt internationally-recognized corporate governance practices when they invest in places of positive institutional mismatch and much less likely to do so if they mainly invest in places of institutional match (i.e. countries with similarly weak or even worse institutional conditions). It raises an empirical question: in what types of foreign countries do Chinese SOEs mainly invest? Do Chinese SOEs mainly invest in countries of positive institutional mismatch, such as the United States? Extant literature has focused on Chinese SOEs' outward investment in Africa. While the SOEs have contributed some significant economic development to Africa, their governance, social and environmental practices there have been criticized for failing to meet international standards by a great margin (Keenan 2009; Chintu and Williamson 2013). If Africa or other weak governance countries are the main investment destinations, it suggests Chinese SOEs' global expansion would face little normative pressure to change their governance practices. But the governance reform potential is more likely if they mainly invest in advanced economies, especially those with regulatory processes scrutinizing investments by foreign SOEs.

The macro-institutional distance between the origin country and the destination country of investment provides a broad-brush baseline model of change potential in the governance of SOEs. But not all SOEs even of the same country would be the same. There are organization-

[68] Supra note 65.

level variances which bring about different inbound influence from outward investment. This chapter focuses on two micro-organizational conditions: the firm's entry modes and investing entity.

Existing literature has shown that a firm's choice of entry modes is affected by the institutional distance between the home country and the host country. Cui and Jiang (2012), for example, show that institutional mismatch is a source of pressure for Chinese SOEs to choose joint ventures rather than acquisitions as the entry mode because acquiring an existing business is more likely to face regulatory or political hurdles. While the original choice of entry modes is affected by institutional distance between the home country and the host country, once the choice has been made, the choice can subsequently produce different levels of inbound influence derived from such outward activity.

Common entry modes into foreign markets include two categories: equity-based and non-equity based. Non-equity based entry modes are exporting and licensing. Because non-equity based entry modes have little exposure to the corporate governance system in the host country, it would induce only marginal inbound influence on the governance of SOEs in the home country. Equity-based entry modes can be divided by ownership into two types: wholly-owned and partially-owned operations. Wholly-owned operations are green-field investment (i.e. setting up wholly-owned subsidiaries) and full acquisition of existing local firms in the host country. Partially-owned operations refer to partial acquisition of existing local firms and setting up joint ventures with local firms in the host country. Among all these equity-based types, greed-field investment is the most integrated with the SOE operations in the home country and the least exposed to direct interaction with corporate governance of local firms in the host country. Therefore, the inbound influence on corporate governance of the parent SOE in the home

country can be limited. Compared to green-field investment, full acquisition has a higher level of exposure to corporate governance practices in the host country. Takeovers by foreign investors may be subject to regulatory approval conditioned on some governance changes of the investing SOE. Moreover, old practices in the acquired company may continue and thus potentially diffuse to the parent SOE in the home country. Partially-owned operations also possess great potential of inbound influence. Partial acquisition and joint ventures require SOEs to negotiate and arrange governance structures with local shareholders. The ownership interaction and integration create opportunities for SOEs to learn the operation of the corporate governance system in the host country. [Table 24] summarizes the types of entry modes and the levels of potential inbound influence on corporate governance of SOEs in the home country.

[Table 24]
Entry Modes and Potential Inbound Influence on Corporate Governance

Entry Modes	**Potential Inbound Influence on Corporate Governance**
Non-Equity Based	
Exporting	Low
Licensing	Low
Equity-Based	
Wholly-Owned Operations	
Green-Field Investment	Low-Medium
Full Acquisition	Medium-High
Partially-Owned Operations	
Partial Acquisition	Medium-High
Joint Ventures	Medium High

When deciding how to invest in a foreign country, firms need to decide whether to invest directly itself or through subsidiaries. As explained in Chapter 1, the ownership structure of the Chinese SOE is a hierarchy controlled by the core company in the business group. The layers of ownership create degrees of distance between the core company and their overseas subsidiaries. Close ties produce stronger influence than distant ties do. On the one hand, the multiple layers of ownership may distance overseas subsidiaries from the state control, which may give more

freedom for overseas subsidiaries to adopt local corporate governance practices in the host country. (But it may also create more agency problems as SASAC hasn't had a good track of Chinese national champions' overseas activities).[69] On the other hand, the distance from the core company and the state-owner may weaken the potential inbound influence on the core company. It leads to a hypothesis that foreign investments made directly by the core company may bring out more inbound influence on the core company than those made by the core company's subsidiaries.

In addition to foreign direct investment, overseas listing is another important strategy for Chinese SOEs to build international equity connections. Some Chinese SOEs have listed shares in the world's leading capital markets including Hong Kong, Singapore, U.S. and UK. The institutional relationship between China and the major capital markets can be characterized as institutional mismatch. According to the bonding theory in corporate governance literature, firms with a view to improve corporate governance, particularly those from emerging markets, may cross-list their shares in a better governance regime (Coffee 2002). By cross-listing in a stronger institutional regime such as US, Chinese SOEs must comply with stricter standards and consequently have better governance. Chi and Zhang (2010) show that Chinese firms cross-listed in Hong Kong has better pay-performance sensitivity than the mainland firms without cross-listing and the effect is greater for SOEs than private firms. Cong et al. (2010) also find Chinese firms listed in Hong Kong and Singapore have better corporate governance quality (measured by a combined index) than their counterparts with domestic listing only. Hung et al. (2008) find

[69] In response to an outbreak of SOE overseas investment scandals, SASAC promulgated Provisional Measures on Supervising Central Enterprises' Overseas Assets (2011) and Provisional Measures Managing Central Enterprises' Overseas Property Rights (2011) and Provisional Measures Managing Central Enterprises' Overseas Investment (2012). As of 2011, 27.3% of the about 2000 overseas subsidiaries of the central SOEs were running at a loss and 72.7% were making profits or breaking even, according to the Department Head (Mr. Ziming Shi)of Outward Investment and Economic Cooperation, Ministry of Commerce Press Conference Aug. 31, 2012.

that China's overseas listed SOEs have more professional boards of directors, greater accounting conservatism, higher investment efficiency and better stock performance than their domestically listed counterparts. Given that the overseas listed firms are major members of the state-owned business groups and their top management teams (including boards of directors) very often overlap with the teams of the core companies, the overseas listed subsidiaries may diffuse modern corporate governance practices such as independent directors back to the core companies. It raises an empirical question: do overseas listing help diffuse positive corporate governance reform back to the parent SOE?

5.3 Data and Methods

The SOEs under the central SASAC's control are the dominant players of China's outward investment. At present, there are 113 enterprises under the central SASAC's supervision. As explained in Chapters 1 and 2, these enterprises are organized as business groups within which the core companies control a large army of subsidiaries. According to the official data, in 2011, the non-financial SOEs under the central government's control accounted for (at least) 67.2% of the outward FDI (flow).[70] Of the top100 non-financial companies by outward FDI stock in 2012, 57% are SOEs owned by the central government, 31% owned by local governments and only 12% private.[71] This chapter will focus on the 113 central SOEs to evaluate how international connections would influence the SOE governance reform in China.

The dependent variable is governance change. The most important governance reform of the central SOEs is the institutionalization of the board of directors and independent directors. In 2004, the central SASAC with the State Council's approval, began to experiment with the idea of

[70] 2011 Statistical Bulletins of China's Outward Foreign Direct Investment (published by Ministry of Commerce of People's Republic of China, National Bureau of Statistics of People's Republic of China, and State Administration of Foreign Exchange).
[71] Released by Ministry of Commerce 2013.

establishing the board of directors in the SOEs' under its supervision. According to the SASAC's initial design, the board of directors generally should be comprised of no less than 9 directors and at least 2 should be outside directors; and the percentage of outside directors should gradually increase with improvement in the supply of outside directors.[72] As per SASAC's most recent rules, the board size generally should be between 7 and 13 directors with a majority as outside directors.[73] Note that although most of the central SOEs did not have a board of directors before SASAC's policy, there were a number of exceptions. For instance, China Chengtong Holdings Group Ltd, a diversified industrial group, had established the board of directors as early as 1992. These pre-SASAC boards were comprised of insiders only and some had only chairman and vice-chairman without any other board members. Unlike the pre-SASAC board, the new board model that SASAC promotes is featured with outside directors. The adoption of outsider directors appears that China's SOEs are converging on the international standard (or the Anglo-Saxon model). Such governance change however is more in the form than in the substance because the board of directors lacks the very essential power to appoint top managers and outsider directors are often retired government officials or former SOE executives. Nevertheless, it may be a step forward to approaching actual governance change. This chapter uses the existence of outsider directors on the board to represent a type of governance change. The data regarding whether and when the SOE has the board of directors and outside directors were manually collected from the personnel appointments announcements and enterprise reform releases posted on SASAC's website. Corporate websites, annual reports, securities prospectuses and news reports are also used as a supplementary source. According to the data collected

[72] Article 16, Opinions on Constructing the Board of Directors of the Wholly-Owned State-Owned Enterprises (Experimental), released on June 10 2004, SASAC Development & Reform (2004) No. 229.
[73] Article 22, Provisional Measures on Regulating the Operation of Experimental Boards of Directors of Central Enterprises, March 20, 2009.

through this methodology, as of 2013, 45 of the 113 SOEs had at least one outside director on the board.[74]

In addition to the existence of outside directors, the existence of foreign educated executives is another indicator of governance change. As the SOEs become multinational firms, their management teams would include professionals with international experience. As shown in Chapter 3, the executive market is overwhelming dominated by system-siders and only a marginal minority of the CEOs have foreign education experience. Having executives who have overseas study experience is a change to the governance tradition. This chapter collected data on educational backgrounds of the CEOs and vice CEOs of the 113 SOEs in the year of 2013. The biographic information was collected from the corporate websites, annual reports, government websites and documents, and industrial association websites, and news reports. There are 638 executive observations (113 CEOs and 525 Vice CEOs). Of the 638 executives, 59 hold a foreign degree; and of the 113 SOEs, 39 have at least one foreign-educated executive.

The independent variables include multiple dimensions of internationalization. International equity connections are the focus of this chapter. International equity connections may be constructed in many forms and will be tested in following ways. First, international equity connections can be made through cross-border joint ventures, mergers and acquisitions. Data on cross-border joint ventures as well as mergers and acquisitions were manually collected from the SDC Platinum Database. The transactions include the deals by the core company itself or its subsidiaries. The dataset cover the years from 2003 to 2011. The degree of internationalization is operationalized as the number of deals accumulated from 2003 to (t-1)

[74] Note that there are cases where the board of directors was established but the positions of outside directors were not filled or could not be confirmed through publically available data. The cases typically happened for firms that just announced to establish the board in 2012 or 2013.

year.[75] Point-biserial correlation will be performed on the relationship between the accumulated number of deals (t-1) and the dependent variable (t). Furthermore, to empirically examine how location (advanced or emerging economies) and investment identity (core or subsidiary) would affect governance change, the correlation models will be performed on various segments of the dataset, including all kinds of deals regardless of location and investment identity, deals in advanced economies only, deals by core companies only, and deals by core companies in advanced economies.

Second, data on the central SOEs' overseas subsidiaries were collected from Directory of Overseas Investment Institutions, a database maintained by the Ministry of Commerce of China. The database contains the new establishments of overseas investment entities subject to the Ministry of Commerce's approval. While not all establishments of overseas operations are subject to regulatory approval, the data can serve as an estimate of the number of overseas subsidiaries.[76] The database covers the central SOEs' investments as early as 1983, but most of the investment occurred after 2000, the year in which the "going global" policy was formally introduced. According to the database, as of 2012, the central SOEs established 1,680 overseas operations. The degree of internationalization is measured as the accumulated number of overseas subsidiaries toward t-1.The statistical methods will be similar to the above models used for the data collected from SDC Platinum.

Third, overseas listing is another way to build international equity connections. Simple linear regression will be used to examine the relationship between the time of overseas listing and the time of introducing independent directors. Moreover, Cramer's V will be used to show

[75] SDC Platinum Database does not provide the dollar amount of every transaction.
[76] According to the State Council's Decision on Investment Reform (2004), all of the central SOEs' overseas investments should be subject to approval or notice, depending on the size of the investment. Measure on Overseas Investment (2009) provides that the latest conditions under which the investment should be subject to approval by Ministry of Commerce.

whether the core company has an overseas listed subsidiary has a strong or weak correlation with the existence of independent directors and executives who have foreign education experience.

Fourth, this chapter will use logistic regressions to examine the relationship between internationalization and governance attributes. The dependent variables will be whether there is any outside director on the board in 2013 and whether there is any foreign-educated top manager in 2013. The independent variables will be various internationalization indicators including the accumulated number of acquisitions toward 2011, the accumulated number of joint ventures toward 2011, the accumulated number of overseas subsidiaries as of 2012, and whether the group has an overseas listed firm (yes=1). The control variables will be as follows: logged revenues (2010) to control for firm size, ROA for efficiency (2010), and the status of the group in the government bureaucratic hierarchy. Groups that hold a higher status in the government system (i.e., a vice-ministerial rank) would be more impervious to international pressure as they are closer to the inner circle of China's domestic political power.

5.4 Results and Analysis

[Table 25] shows the number of the central SOEs' overseas acquisitions, joint ventures and subsidiary establishments by country in the period of 2003-2011. Hong Kong has been an important place for the central SOEs' activity in overseas acquisitions, joint ventures and subsidiaries. However, Chinese SOEs' investments in Hong Kong very often are simply "round-tripping" -- where Chinese firms take money offshore, dress up in financial secrecy, then return back home to illegally enjoy the tax benefits available only to foreigners (Xiao 2004, Morck et al. 2008).[77] Moreover, the SOEs often use Hong Kong incorporated companies to engage in investment in other countries, which makes Hong Kong more a portal than a destination of the SOEs' foreign investment (Morck etl al. 2008). Excluding Hong Kong, the top countries of the central SOEs' acquisition activities are Australia, Canada, United States, Singapore and United Kingdom. These countries (except Singapore) economically happen to be economically liberal markets per the varieties-of-capitalism literature, politically mature democracies, and all in the Anglo-Saxon law family. In other words, the central SOEs' acquisition activities take place significantly in countries whose institutional environments are very dissimilar to China – economically having pervasive state ownership, politically being non-democratic and in the civil law system ("bad" corporate law regime per the law and finance literature). The high degree of institutional mismatch suggests Chinese SOEs would face great normative pressure on their governance structure when entering into these markets.

[77] See supra note 66.

[Table 25]

Overseas Acquisition Deals of China's National Champions, 2003-2011

Location of Acquisitons	**Location of Joint Ventures**	**Location of Subsidariy Establishements**
Number of Acquisition Deals (%)	**Number of JV Deals (%)**	**Number of Subsidairy Establishments (%)**
Hong Kong	Australia	Hong Kong
198 (35.5%)	26 (12.3%)	360 (15.5%)
Australia	Hong Kong	United States
76 (13.6%)	21 (10.0%)	91 (3.6%)
Canada	United States	United Arab Emirates
47 (8.4%)	21 (10.0%)	64 (2.8%)
United States	Canada	Australia
27 (4.8%)	11 (5.2%)	62 (2.7%)
Singapore	Russia	Singapore
20 (3.6%)	11 (5.2%)	55 (2.4%)
Brazil	Saudi Arabia	British Virgin Island
18 (3.2%)	8 (3.8%)	54 (2.3%)
United Kingdom	Taiwan	Saudi Arabia
16 (2.9%)	7 (3.3%)	48 (2.1%)
Nigeria	Indonesia	Russia
8 (1.4%)	6 (2.8%)	45 (1.9%)
Kazakhstan	Japan	Germany
8 (1.4%)	5 (2.4%)	39 (1.7%)
Chile	India	Indonesia
8 (1.4%)	5 (2.4%)	39 (1.7%)
Indonesia	South Korea	Zambia
8 (1.4%)	5 (2.4%)	38 (1.6%)
Others	Others	Others
124 (1.4%)	85 (40.3%)	1,431 (61.5%)
Total	Total	Total
558 (100%)	211(100%)	2,326 (100%)
Chinese Aquisitor (by type)	**Chinese JV Partner (by type)**	**Investing Entity**
Core Company	Core Company	Core Company
90 (16.1%)	77 (34.5%)	192 (8.3%)
Subsidiary	Subsidiary	Subsidiary
468 (83.9%)	134 (63.5%)	2,134 (91.7%)
Total	Total	Total
558(100%)	211 (100%)	2,326 (100%)
Ownership Stake After Acquisition	**Equity Stake in JV**	
<50	<50	
77 (13.8%)	36 (17.1%)	
>=50	>=50	
190 (34.1%)	93 (44.1%)	
Unknown	Unknown	
291 (52.2%)	82 (38.9%)	
Total	Total	
558 (100%)	211(100%)	
Average Stake	Average Stake	
68.9% (N=267)	48.9% (N=129)	

Source: raw data on acquisitions and joint ventures are manually collected from the SDC Platinum M&A database; raw data on subsidiary establishments are manually collected from Directory of Overseas Investment Institutions published by Ministry of Commerce of China.

[Table 25] also shows that excluding missing data, a majority of the deals are acquisitions of absolute controlling stakes, with an average stake at 68.9% after acquisition. The popularity in controlling ownership stakes suggests Chinese SOEs may be more interested in being an active controller than a passive observer in corporate management. Their control interest is often suspected especially when there is a great degree of institutional mismatch between China and

the investment destinations. The central SOEs' major investment destinations including Australia, Canada, the United State and the United Kingdom have a foreign investment review system that can block acquisitions by foreign investors based on concerns to national security and/or economic benefits. Under the foreign investment regulatory review, the foreign acquiring entity may be required to comply with certain conditions imposed by the regulators in exchange for regulatory approval. For example, CNOOC Ltd., a major subsidiary of China National Offshore Oil Corporation, a wholly-stated owned enterprise under the central SASAC's supervision, agreed to the Canadian government that it will list its shares on the Toronto Stock Exchange in exchange for the government's regulatory approval to its $15.1 billion takeover of Nexen Inc., a Canadian oil and gas company. The share listing requirement is intended as a measure to make CNOOC Ltd.'s corporate governance practices consistent with Canadian standards. The foreign investment regulatory review systems in these advanced economies where Chinese SOEs mainly investment present a potential mechanism to influence the SOE governance.

While the normative pressure imposed by the macro-institutional environments may make Chinese SOEs learn and converge on the international governance standards, the learning and convergence potential can be lessened by the use of indirect investment vehicles. [Table 25] shows that 83.9% of the acquisitions are done through the downstream subsidiaries rather than the core companies in the business groups. As discussed in Section 2.3, the subsidiaries are embedded in the business group network controlled by the core company and ultimately by the party-state. This ownership structure can effectively shield the core company and the party-state from disclosing their governance practices and even hide actual practices in subsidiaries. In such cases, the core companies are not directly exposed to the normative pressure; therefore, the governance influence effects, if at all, tend to be limited to the subsidiaries.

In addition to direct acquisitions, joint ventures are another type of international equity connections. Australia, the United States, and Canada again have the highest concentration of the foreign joint ventures deals. About 35% of the joint ventures are established through the core companies, much higher than the acquisition deals where there are only about 16% via the core companies. Because joint ventures are usually not subject to regulatory review requirements, core companies themselves even without using subsidiaries as the shield can still maintain obscurity about their governance practices to foreigners.

[Table 25] also shows the geographic distribution of subsidiary establishments. Hong Kong again tops the list as it has been used as a main portal to foreign investment. Unlike mergers and joint ventures, subsidiary establishments do not present obvious concentration in a few advanced economies but wide dispersion in various countries. Moreover, most (91.7%) of them are established through subsidiaries rather than core companies. The investment locations and the indirect relationship with the parent SOEs suggest little impact on the parent SOEs through overseas subsidiary establishments.

[Table 26] further shows the correlation between various internationalization indicators and whether the core company has any outside director on its board. The degree of internationalization, whether measured as the number of overseas acquisitions, the number of overseas joint ventures or the number of overseas subsidiary establishments, has a very weak or virtually zero correlation with the existence of an outside director on the board. Investments directly by the core companies themselves do not present a better chance of adopting an outside director. Neither do investments in Australia, Canada and the United States present a meaningful correlation, despite there is a high degree of institutional mismatch and regulatory pressure to

potentially change governance. Internationalization is also virtually irrelevant to whether the SOE has any foreign-educated executive, as shown in [Table 27].

[Table 26]

Point-Biserial Coefficients between Internationalization and Outside Directors

	2005	2006	2007	2008	2009	2010	2011	2012
Correlations between Number of Acquisitions and Existence of Outside Directors								
All Deals	.008	-.027	-.049	-.067	-.111	-.120	-.141	-.006
Deals by Core Companies	-.045	-.091	-.074	-.084	-.132	-.126	-.169	.046
Deals in Advanced Economies (Hong Kong Excluded)	.123	-.031	-.024	-.045	-.084	-.093	-.119	.009
Deals in Advanced Economies (Hong Kong Included)	.110	-.003	-.028	-.057	-.106	-.116	-.125	-.021
Deals by Core Company in Advanced Economies (Hong Kong Excluded)	-.037	-.085	-.032	-.010	-.101	-.109	-.172	.073
Deals by Core Company in Advanced Economies (Hong Kong Included)	-.038	-.085	-.032	-.019	-.109	-.119	-.182	.086
Deals by Core Company in Australia, Canada, USA	-.023	-.067	-.079	-.086	-.128	-.123	-.173	.027
Correlations between Number of Joint Ventures and Existence of Outside Directors								
All Deals	.082	-.039	-.024	-.037	-.043	-.086	-.099	.051
Deals by Core Companies	.103	-.032	-.004	-.019	-.026	-.072	-.071	.052
Deals in Advanced Economies (Hong Kong Excluded)	-.065	-.023	-.052	-.058	-.024	-.080	-.041	.111
Deals in Advanced Economies (Hong Kong Included)	-.062	-.050	-.061	-.074	-.064	-.113	-.082	.046
Deals by Core Company in Advanced Economies (Hong Kong Excluded)	-.022	-.053	-.058	-.001	.020	-.065	.059	.126
Deals by Core Company in Advanced Economies (Hong Kong Included)	-.022	-.065	-.069	-.014	.006	-.074	.048	.103
Deals by Core Company in Australia, Canada, USA	---[a]	-.040	-.041	056	.038	-.046	-.057	-.044
Correlations between Number of Overseas Subsidiaries and Existence of Outside Directors								
All Establishments	-.052	.015	.146	.013	.006	-.018	-.032	.008
Establishments by Core Companies	-.052	.058	.131	.121	.054	.121	.162	.168
Establishments in Advanced Economies (Hong Kong Excluded)	-.067	.051	.084	.041	.049	.031	.058	.120
Establishments in Advanced Economies (Hong Kong Included)	-.047	.101	.136	.105	.077	.046	.052	.165
Establishments by Core Company in Advanced Economies (Hong Kong Excluded)	-.046	.063	.037	.026	-.018	-.039	.047	.107
Establishments by Core Company in Advanced Economies (Hong Kong Included)	-.049	.056	.029	.014	-.038	-.032	.066	.161
Establishments by Core Companies in Australia, Canada, USA	-.037	.022	.004	-.014	-.067	-.075	.107	.097
N	113	113	113	113	113	113	113	113

Deals are accumulated to the prior year. For example, in 2005 the correlation is between the deals accumulated until 2004 (t-1) and whether the firm had an outside director in 2005 (t). Advanced economies include countries according to IMF Advanced Economies List (World Economic Outlook, October 2012, p. 180).

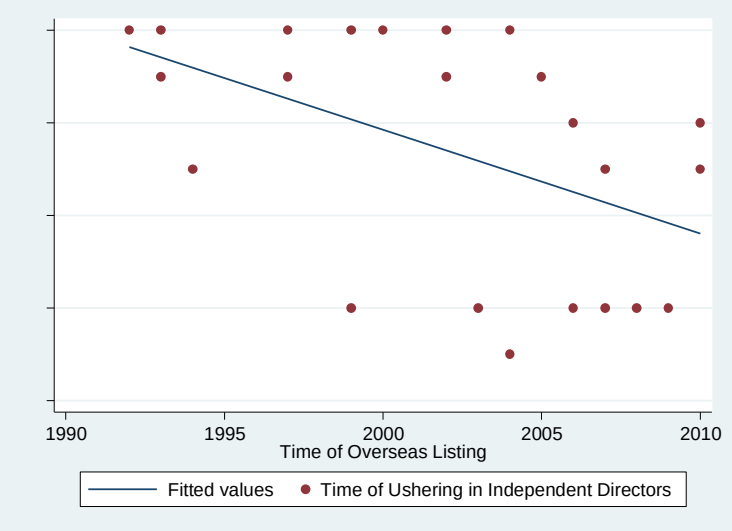
[a] All the observations have zero deals by core company in Australia, Canada or USA; therefore, no value can be provided.

[Table 27]
Point-Biserial Coefficients between Internationalization and Foreign-Educated Top Managers

	Existence of Foreign-Educated Top Manager (2013)
Accumulated Number of Acquisitions (2011)	
All Deals	.089
Deals by Core Companies	.145
Deals in Advanced Economies (Hong Kong Excluded)	.071
Deals in Advanced Economies (Hong Kong Included)	.098
Deals by Core Company in Advanced Economies (Hong Kong Excluded)	.194
Deals by Core Company in Advanced Economies (Hong Kong Included)	.205
Deals by Core Company in Australia, Canada, USA	.148
Accumulated Number of Joint Ventures (2011)	
All Deals	.156
Deals by Core Companies	.191
Deals in Advanced Economies (Hong Kong Excluded)	.093
Deals in Advanced Economies (Hong Kong Included)	.109
Deals by Core Company in Advanced Economies (Hong Kong Excluded)	.194
Deals by Core Company in Advanced Economies (Hong Kong Included)	.161
Deals by Core Companies in Australia, Canada, USA	.071
Accumulated Number of Subsidiary Establishment (2012)	
All Establishments	.039
Establishments by Core Companies	.133
Establishments in Advanced Economies (Hong Kong Excluded)	.009
Establishments in Advanced Economies (Hong Kong Included)	.013
Establishments by Core Company in Advanced Economies (Hong Kong Excluded)	.063
Establishments by Core Company in Advanced Economies (Hong Kong Included)	.093
Establishments by Core Companies in Australia, Canada, USA	-.037
N	113

[Figure 17] shows a simple linear regression on time of overseas IPO (initial public offering) and time of introducing outsider directors. It shows that early overseas listing is associated with later adoption of outsider directors. In other words, the parent SOE that is supposed to have a longer exposure to international corporate governance through its overseas listed subsidiary tends to adopt outsider directors later rather than sooner. The idea that internationalization as a main driver of governance reform for China's SOEs is again called into doubt.

[Figure 17]
Correlation between Overseas Listing Time and Time of Ushering in Independent Directors



Source	SS	df	MS	Number of obs =	23
				F(1, 21) =	6.72
Model	35.7343763	1	35.7343763	Prob > F =	0.0170
Residual	111.743885	21	5.32113736	R-squared =	0.2423
				Adj R-squared =	0.2062
Total	147.478261	22	6.70355731	Root MSE =	2.3068

independentdi~s	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
overseaslisting	-.2241928	.0865129	-2.59	0.017	-.4041061	-.0442794
_cons	2458.235	173.2032	14.19	0.000	2098.039	2818.431

[Table 28] shows logistic regressions on various internationalization indicators and governance attributes. Models 1-5 show the relationship between internationalization and

existence of any outside directors on the board. Note that in Models 2-5 all the odds ratios for international indicators are close to 1, suggesting virtually no relationship between internationalization and existence of outsider directors. The odds ratios for number of overseas acquisitions (.968), number of overseas joint ventures (.916) and number of overseas subsidiary establishments (.996) are actually less than 1. In other words, more internationalization is less likely to having outsider directors on the board, which is counterintuitive and against the proposed hypotheses in this chapter. While having an overseas listing subsidiary increases the odds of having an outside director on the board in the parent SOE, the effect is very minimal, by only 2.9% (b=1.029, Model 5).

[Table 28]

Logistic Regressions on Internationalization and Governance Attributes, Odds Ratios

	Existence of Outside Director (2013) (Yes=1)					Existence of Foreign Educated Top Manager (2013) (Yes=1)				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Internationalization Indicators										
Number of Overseas Acquisitions (2003-2011)		.968 (.025)					.998 (.020)			
Number of Overseas Joint Ventures (2003-2011)			.916 (.056)					1.063 (.064)		
Number of Overseas Subsidiary Establishments (toward 2012)				.996 (.008)					.998 (.008)	
Overseas Listing (Yes=1)					1.029 (.539)					.277* (.161)
Controls										
(log)Revenues (2010)	1.564* (.275)	1.717** (,335)	1.767** (.356)	1.618* (.307)	1.558* (.295)	.896 (.145)	.902 (.154)	.830 (.148)	.911 (.158)	1.035 (.185)
ROA (2010)	1.119 (.093)	1.138 (.099)	1.150 (.100)	1.118 (.093)	1.119 (.092)	1.123 (.090)	1.124 (.091)	1.105 (.090)	1.122 (.090)	1.129 (.096)
Status (Vice-Ministerial Level=1)	.630 (.340)	.753 (.417)	.736 (.407)	.610 (.332)	.627 (.342)	1.939 (1.066)	1.965 (1.099)	1.744 (.989)	1.914 (1.056)	2.706 (1.656)
Constant	.035** (.039)	.029** (.025)	.016** (.021)	.030** (.035)	.036** (.040)	.546 (.526)	.526 (.531)	.851 (.891)	.510 (.509)	.352 (.355)
X^2	9.48(3)	11.48(4)	11.66(4)	9.73(4)	9.48(4)	3.75(3)	3.76(4)	4.85(4)	3.82(4)	9.06(4)
p-value	.024	.022	.020	.045	.050	.290	.439	.304	.431	.060
N	92	92	92	92	92	92	92	92	92	92

*p < .05, ** p <.01. However, given the sample size is close to the whole population and the purpose of the study is to provide a historical review rather than future prediction, p-values are not the focus of interpretation.
The coefficients reported in this table are odds ratios. An odds ratio less than 1 suggests that the event is less likely to occur in the group coded 1 than in the group coded 0. An odd ratio close to 1 indicates little effect. Cohen's (1988) rule of thumb for interpreting odds ratios is as follows: 1.5 = small, 2.5= medium and 4.3 = large.

Models 6-10 show the relationship between internationalization and existence of any foreign educated executive. Note that the odds ratios of number of overseas acquisitions (.998), number of joint ventures (1.063), and number of overseas subsidiary establishments (.998) are close to 1, indicating virtually no relationship between these internationalization indicators and existence of any foreign educated executive in the parent SOE. Moreover, having overseas listed subsidiary significantly reduces the odds of having a foreign educated executive in the parent SOE by 72.3% (=1-0.277). The result is contrary to the expectation that overseas listing would expose the parent SOE to international corporate governance and thus increase the chances of including a foreign-educated professional in the top management team.

For control variables, SOEs with larger revenues are more likely to adopt outside directors but generally less likely to have foreign educated executives. More profitable firms (measured by ROA) are more likely to have outside directors and foreign-educated top managers.

The SOEs with a vice-ministerial rank in the government system are less likely to have outsider directors on the board but more likely to have foreign educated executives.

5.5 Discussion

The empirical findings in this chapter find little evidence that international equity connections play any significant role in the governance reform pattern of China's central SOEs. Chinese SOEs' international investment activity appears virtually irrelevant to their governance reform pace. It casts a shadow over the optimistic view that international exposure would be an effective driving force to change the SOEs' governance practices. It also raises a set of related questions. Why does the SOEs' international investment activity have little bearing on their governance reform pace? If it is not internationalization, what is the main force in driving their governance reform pattern? Three explanations are offered to explain the limited effect of internationalization on the SOE governance reform pace.

First, the idea that international equity connections either through FDI or overseas listing can push for governance change of the parent SOE assumes that there is some diffusion of governance practices flowing from the host country back to the headquarters in the home country. However, the diffusion influence may be diluted through layers of ownership that shield the parent SOE from transparency and pressure to reform. As shown previously in [Table 25], a majority of investment deals are done through subsidiaries rather than the core companies themselves. This investment structure may weaken the potential governance influence. Moreover, while the top investment destinations are advanced economies with regulatory processes scrutinizing investments by foreign SOEs, they only account for a minority of the transactions. As of the 558 acquisitions, only 150 of the deals are invested in Australia, Canada

and United States; and of the 150, only 26 are by core companies. As a result, the SOEs may have insufficient direct exposure to the environments of high institutional mismatch.

Second, it entails an inquiry into Chinese SOEs' globalization motivation. The Chinese government formally ushered in the "going global" policy in 2000. A review of the government policy statements shows that the "going global" policy is aimed to participate in international technology cooperation and competition, take full advantages of international and domestic markets, encourage external processing trade, resources exploration as well as international construction contracting and develop a collection of multinational companies and well-known brands. Corporate governance improvement seems not a primary consideration from the policymaker's perspective. Consistent with the government's policy, empirical studies have confirmed that market size expansion and natural resources acquisitions are important motives for Chinese SOEs' outward direct investments (Hurst 2011, Buckley et al. 2007, Kolstag &Wilg 2012).

While Chinese policymakers might not intend governance improvement through international trade or outward direct investments, they indeed took overseas listing as an important internationalization strategy to improve SOE governance. Scholars have shown that overseas listed SOEs have lower earnings management, more professional directors on the board, higher investment efficiency and greater firm valuation than their domestically listed counterparts (Hung et al. 2008). However, empirical evidence in this chapter indicates that the positive effects are limited to the listed subsidiaries and not effectively reflected in their parent companies. The lack of positive diffusion to the parent companies may be related to the strategic way Chinese SOEs crafted their overseas listings. The conventional strategy is to carve out the crown jewel assets of the group and bundle them into the listed firm while leaving bad assets and

other problems in the unlisted part of the group, usually the core company (Howie and Walter 2006). This assets segregation strategy may practically concentrate corporate problems in the core company and thus may make the governance reform of the core company more challenging.

Third, the notion that the firm would improve governance as a response to international pressure takes a market-based perspective. It assumes the market power can drive the firm to change its behavior. However, the behavior of China's SOEs is determined not only by market forces but probably more by the government's decisions. It is often the Chinese government rather than the market to select which firms to engage in reform. The Chinese government handpicked which firms could list shares abroad. SASAC selected in batches which SOEs were eligible to experiment with the board of directors and independent directors. SASAC together with the Party's Organization Department consider factors other than market demand when appointing top managers. The lack of correlation between internationalization and governance reform at the firm-level data suggests Chinese policymakers take little account of internationalization in formulating SOE reform agenda. The reform pace is determined by domestic forces rather than by international market or regulatory pressure.

CONCLUSION

This dissertation has tried to open the black box of China's state capitalism by shifting the focus from agency problems in individual listed firms to networks of firms embedded in the party-state. The relational anatomy has provided a better understanding of the architecture of China's state-owned sector that supports the national economic development. It has explained the specific institutional mechanisms that deviate actual governance practices from the laws on the books. It has raised significant questions about the adequacy of international regulatory regimes in addressing investment and other market activity by Chinese SOEs. And it has also cast doubt on the effectiveness of international forces to meaningfully change practices of the very central players of China's state-owned sector.

As Chinese SOEs are embedded a control network densely knitted by various types of relations in addition to legally-defined ownership, making SOEs independent of the party-state's control is not just a matter of privatization. Dis-embedding the SOEs entails drastic political reform that destabilizes all the ties with the single-ruling party. But such political reform is nowhere in sight. Of course, it is not to say the current system will not change. The architecture of China's SOEs is not a static model but a work in progress. Under China's new leadership, another round of SOE governance reform is now underway. Chinese policymakers have outlined a vision for China as a "mixed ownership economy" where the boundary between the state-owned sector and the non-state-owned sector will be more blurred.[78] Under the "mixed ownership" policy, private capital will be invited into the state-owned sector through ways such as public listing and investment at the core-company level. Mixed ownership is expected to "preserve SOEs' value and increase their competitiveness" as well as "exploit the comparative

[78] <Decision on Major Issues Concerning Comprehensively Deepening Reforms> was adopted at the close of the Third Plenary Session of the 18th CPC Central Committee, November 12, 2013.

advantages of various types of ownership for mutual development." State ownership and private ownership have their own distinctive merits and problems. Ownership integration across the state-owned sector and private sector, if done in a right way, may produce synergy and gain competitive edges;[79] but if done improperly, it may complicate the situation. As mixed ownership is expected to be more extensive in the years to come, will it distance SOEs from the state's control, as hoped by liberalization advocates? Alternatively, will ownership integration instead embed private enterprises deeper into the party-state system? The SOEs' dense and complex relations with the party-state as shown in this dissertation give little reason for optimism about these questions.

[79] The idea of "mixed ownership" echoes Stark (1996)'s idea of "recombinant property" to analyze the economic reform in Eastern Europe. Recombinant property is a strategy used to hedge uncertainties by blurring the boundary between state ownership and private property.

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Appendix: Frequent Sequence Mining

Frequent sequence mining is a method to discover all the subsequences that occur frequently among given sequences. There are multiple strategies to find the frequent patterns depending on what types of subsequences to be included. The subsequences of the bank executive career pathways examined in Section 4.3 are *directed* because job movements across organizations are temporal. The subsequences can be *consecutive* and *non-consecutive* (i.e. allowing gaps in subsequence). For example, <a b c> is counted as a subsequence of <a b c a c> and also can be counted as a subsequence of <a c b a c>.

To extract sequential patterns, it starts with the shortest length *k*-subsequence, i.e. *k*=1. For example, given a sequence <a c b a c>, candidate length-1 subsequences are <a> <b> and <c>. Candidate length-2 subsequences are <a c>, < c b>, <b a>, <a c>, <a a> etc. In total, 10 candidate length-2 subsequences can be extracted from the sequence, i.e. $\binom{5}{2} = 10$.

When reporting results, there is a *user-specified minimum support threshold*, commonly denoted as *minsup.* It means reporting patterns which are supported by a minimum percentage of sequences. For example, given sequences <a b c d>, < c c d d>, <a b b d>, <b b c d>, <a c c d>, report length 2-subsequences with *minsup* >=50%. The reported subsequences are <c d> and <a d>.

To apply the frequent sequence mining method, the career pathways are coded in the following way. A career pathway is composed of the organizations that a CEO had ever worked for before assuming the CEO position. There are different types of organizations including financial regulatory institution, first-tier bank, second-tier bank, third-tier bank, foreign bank, industrial SOE, academic institution, other government bureau, and other financial institution. For coding simplification, financial regulatory institution is coded as A, first-tier bank as B, second-tier bank as C, third-tier bank as D, industrial SOE as E, other financial institution as F, other government bureau as G, private/foreign institution as H, and academic institution I.

Each CEO has his or her own sequence, for example, ABCD, meaning job movements from a financial regulatory institution to a first-tier bank, then to a second-tier bank and then to a third-tier bank. Such data structure of the career pathways thus is analyzable with the frequent sequence mining method as explained above.